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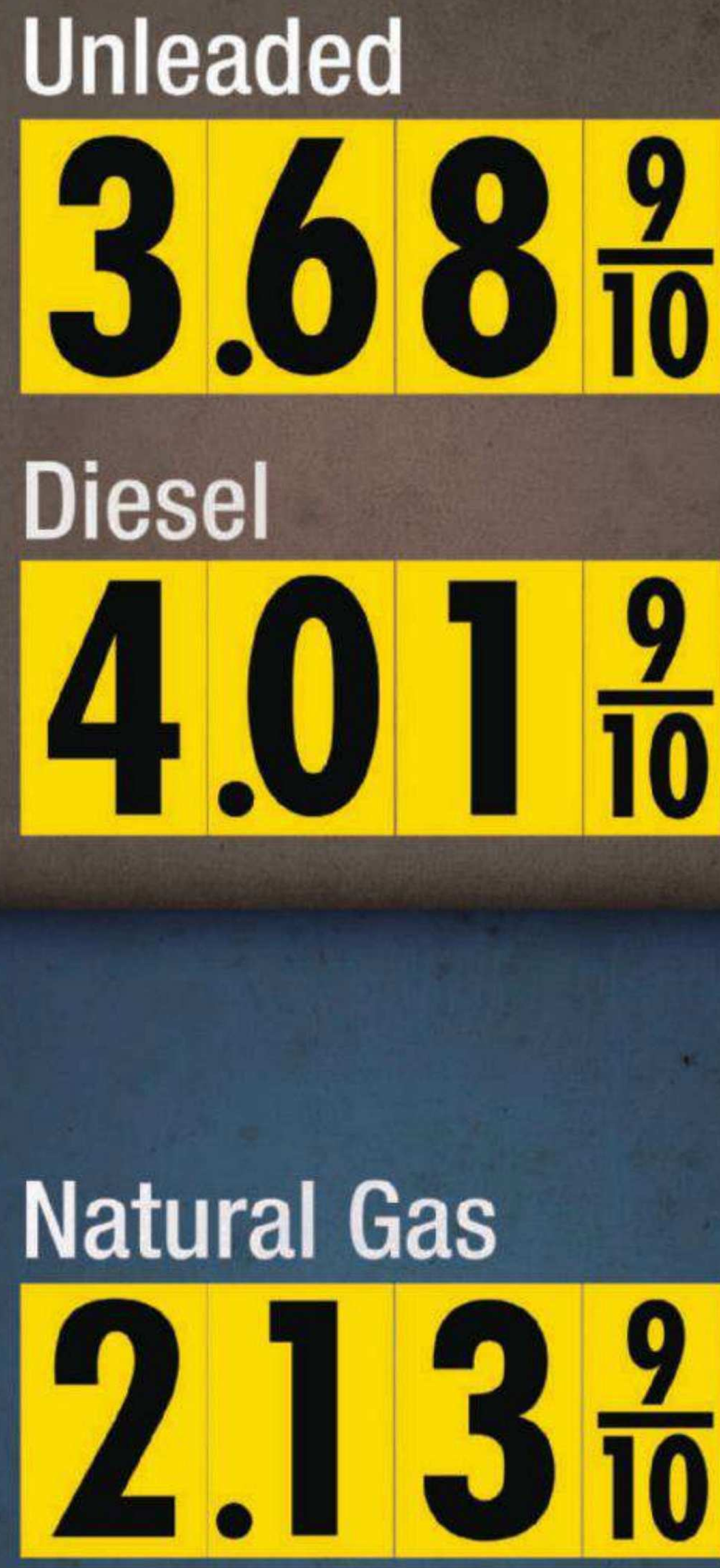
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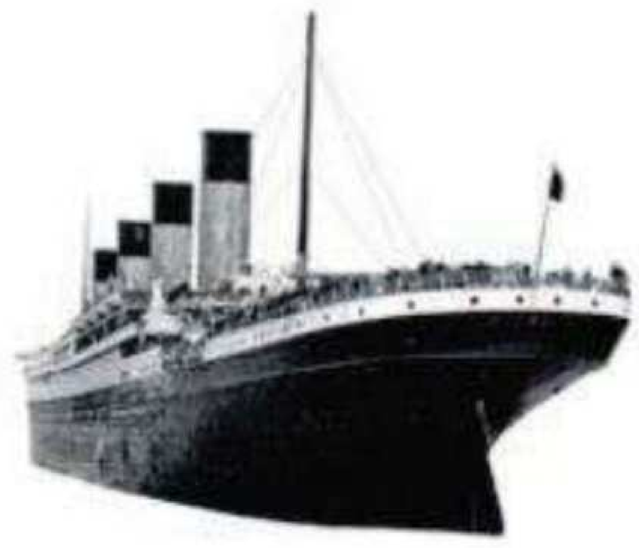
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Corrections & Clarifications

B In "How Gupta Came Undone" (May 23-29), we incorrectly stated that Rajat Gupta was removed from various corporate boards. He resigned.

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The intersection of Bay and King Streets, in Toronto. Home to four of Canada's five major banks, it is the country's financial epicenter.

NORTHERN LIGHT

So close to home you might forget it's "international," Canada and its businesses hold bright prospects for the U.S.

When it comes to amiable collaboration and financial reliability, the U.S. couldn't ask for a better neighbor than Canada. The two trade-driven states share a number of nation-strengthening goals, partnering together culturally, economically and even militarily. It's a well-evolved relationship (an estimated $1.5 billion in goods cross the U.S.–Canada border daily, making Canada America's largest trading partner by far) but there's still further development to be done to make this powerful tag team even sturdier and more efficient.

The cultivation of the 5,525-mile international border—the longest in the world—into a horizon of trade-friendly passageways is an initiative in which both governments have a substantial stake. In February, that objective brought about the creation of the U.S.–Canada Regulatory Cooperation Council, which has a two-year mandate to promote growth through cross-border coordination.

One organization that seeks to expand the partnership between the U.S. and Canada is the American Petroleum Institute (API), a trade association representing an industry that supplies most of America's energy, supports over 9 million U.S. jobs and represents 7.7 percent of the U.S. GDP.

For years, API has heavily advocated the benefits Canadian oil sands bring to U.S. consumers; and an extension of the Keystone Pipeline would increase the flow of Canadian crude oil into the U.S. by 830,000 barrels per day. That extra flow is roughly half of what the U.S. currently imports from the Persian Gulf. "To have such a reliable, stable source of supply for this country, or for the world in general, is incredibly important," says Rayola Dougher, API's senior economic advisor. "Canada is the biggest supplier to the U.S., at 2.6 million barrels daily. We now have the potential to bump that to over 3 million in a very short time."

One of API's key reasons for endorsing this pipeline is to increase America's energy security through North American oil supplies. "Right now, we're living with the

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instability of getting oil from less reliable countries," Dougher continues. "The U.S. is the world's biggest and best oil customer, and there's a massive, non-OPEC supply on offer from our closest energy and largest trading partner."

The pipeline augmentation has been under environmental review in the U.S. for almost three years. Concerns surround high levels of greenhouse gas emissions. "Canadian oil sands development will continue with or without approval of the pipeline," says Dougher. "They're producing this oil, whether we consume it or not. The U.S. and Canada have some of the most stringent environmental standards in the world. Some greenhouse gases are being emitted, but advancing technologies and energy-efficiencies reduce the amount."

The heart of the extension would be located in Hardisty, Alberta, and run through Montana and South Dakota, eventually hooking up with a pipeline already in place in Kansas, and ultimately providing oil to refineries in the Gulf region in Texas.

Another factor strengthening API's stance: U.S. jobs supported by Canadian oil sands development could grow to 465,000 by 2035. (Pipeline construction alone will create 20,000 jobs.) A recent Harris poll showed that 85% of people in the U.S. favor heavier reliance on Canadian oil.

New jobs to the north, coupled with the influx of American spending, could further strengthen the value of the Canadian dollar, which of late has gained parity with (and even edged past) its U.S. counterpart.

OANDA Corp., a U.S. company with product development offices in downtown Toronto, closely examines the juxtaposed value of the Canadian and U.S. dollars (and all other foreign currencies, as well) in its role as a financial services provider and foreign exchange (forex) specialist. OANDA offers clients an online forex trading platform, currency conversion tools and corporate hedging services, as well as exhaustive historical currency data, discussion forums, and extensive news and analysis feeds. OANDA's currency data tools and services are available via oanda.com, and the company's forex trading platform—accessible in Web, mobile, and API versions—is found at fxtrade.oanda.com.

"The Canadians are ready to produce this oil whether the U.S. consumes it or not."

CEO and cofounder Michael Stumm stresses the improvements that the electronic age has brought to forex trading. "Certainly, financial markets are computerized and banks operate huge computer networks to process transactions. But their technology operates on top of outdated business conventions—for example, restricting trades to specific lot sizes. Another archaic rule is the 'two-day settlement,' meaning trades may 'close' in a single mouse-click but take two business days to 'settle.' Two-day settlement restricts the flow of capital and penalizes traders who need equity to fund their next trade," Stumm says. "That made sense when paper had to be moved from one desk to the other, but we brought forex markets into modern times. OANDA clients can trade any odd lot of any amount, down to one dollar, getting the same rates and the same spreads as people doing million-dollar trades. Our automated trading technology executes and settles trades immediately, so account balances are updated in real time."

OANDA is the only forex broker to offer 24/7 trading. To emphasize the importance of this, Stumm draws on a recent example. "Congress came to its budget compromise at midnight, April 15th, which was a Friday. Most currency exchange dealers are closed for business then—you'd have to wait until Monday to speculate on this new knowledge. On our platform, within seconds of the announcement, we saw online trading activity."

OANDA's customers are fully in control of precisely when and what amounts they trade. The company's tech and process innovations ensure that OANDA spreads—the difference between the buy and sell prices of a currency pair—are among the market's tightest. "If you're a forex speculator, you probably have a trading model—you see a price and you want to execute on it. Timing is critically important because prices can move substantially in the micro-domain in one-10th of a second. So you hit a button, and the trade is done," says Stumm. ●



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1 API calculation based on Cambridge Energy Research Associates report, *The Role of Canadian Oil Sands in US Oil Supply*, 2010 (Co-sponsored by API) and U.S. Energy Information Administration report, *Annual Energy Outlook*, 2011

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Opening Remarks

The Price of Clean Air

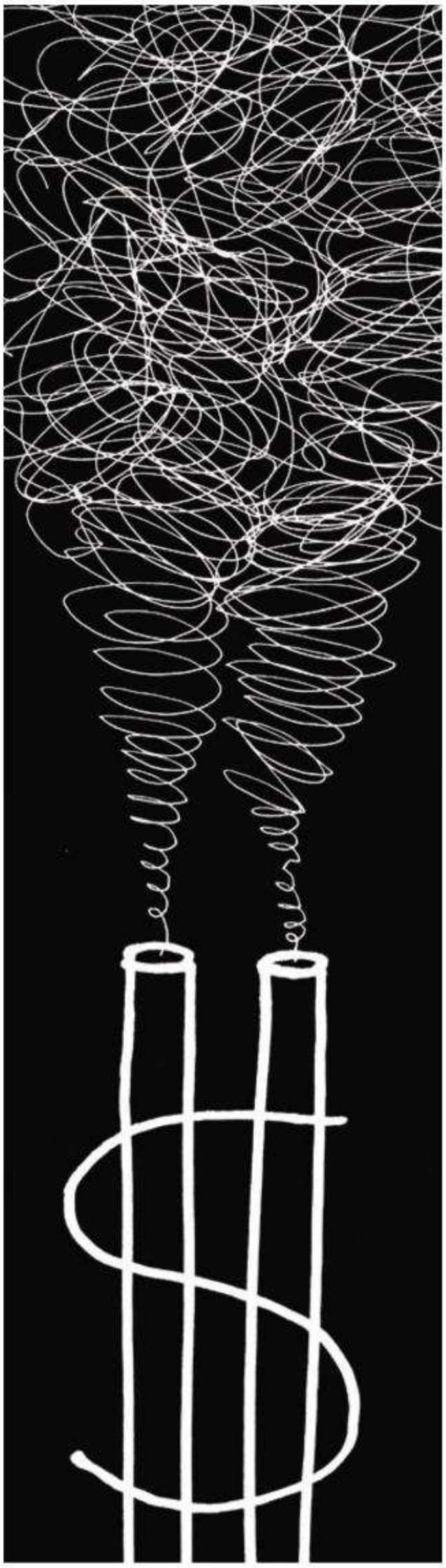
It's not nearly as hard to calculate the economic impact of anti-pollution regulation as you might think. Neither is acting on the data. By Paul M. Barrett

The Fisk Generating Station in the working-class Pilsen neighborhood on Chicago's Lower West Side once symbolized the future. The largest of its kind when it opened, the single-stack, coal-fired plant powered factories and residences throughout a growing metropolis.

That was in 1903. Today, Fisk and its slightly younger sister, the Crawford Generating Station, located nearby in another densely packed area, are relics: two of the more than 200 "legacy" coal-burning plants nationwide that were grandfathered in under 1977 amendments to the Clean Air Act. As a result of legislative compromise, these aging plants remain exempt from some of the act's main requirements that industrial facilities use modern pollution control methods.

Living in Pilsen provides a time-travel experience to an era when the air in American cities was grittier and more dangerous. "Around here, you get this thin gray film of dust on your windowpane and on the patio furniture," says Jerry Mead-Lucero, a local activist who lives near Fisk. "A lot of people don't have air conditioning, so the windows are open in the warm weather, and dust gets into your home or apartment."

And your lungs. Fine particulate matter, sulfur dioxide, and nitrogen oxide emitted by the Fisk and Crawford plants exacerbate respiratory and cardiac conditions, according to public health advocates. A study led by a Harvard School of Public Health professor and published in 2002 in the journal *Atmospheric Environment* linked the two Chicago plants to 41 premature deaths a year, as well as 550 emergency room visits. As if that weren't enough, Mead-Lucero points out, electricity from Fisk doesn't even go to local residents; the grid sends it to customers elsewhere.



Lawmakers gave Fisk, Crawford, and their ilk a Clean Air Act pass based on the expectation that the old plants would soon close anyway because of decrepitude and inefficiency. The act requires that if such plants are modernized, their owners have to bring them up to code. Congress didn't anticipate that some power companies would forgo modernization. "A lot of utilities have used chewing gum, duct tape, and rubber bands to keep the old plants running, while arguing in court that the changes are merely 'routine maintenance,'" says Henry Henderson, Midwest program director of the Natural Resources Defense Council. The nonprofit NRDC has sued—so far unsuccessfully—to try to force Fisk and Crawford to clean up or shut down.

The plants' owner, Midwest Generation, a unit of Rosemead (Calif.)-based Edison International, says that it cares about the environment and public health. It also says it obeys the Clean Air Act and all other relevant laws. Over the years the company has reduced the release of mercury and certain other contaminants, adds Douglas McFarlan, Midwest Generation's senior vice-president for public affairs. "We have no problem with the rules continuing to get tougher and tougher," he says. "Our analysis shows, though, that even if our plants closed, you would not see a real difference in Chicago. There are a lot of sources of pollution, and you have to look at the situation holistically."

The confounding problem of Chicago's antiquated power plants is more than a local concern. The situation sheds light on a debate unfolding 700 miles away in Washington over whether to step up enforcement of the Clean Air Act or slip back in the direction of Pilsen.

At least 19 Republican-sponsored bills have been introduced in both houses of Congress seeking to prevent the Environmental Protection Agency from taking actions such as limiting emission of climate-warming greenhouse gases and imposing tougher rules for ground-level pollutants such as mercury. Republicans and their industry allies warn that asser-

ILLUSTRATION BY EMILY KEEGIN & MAAYAN PEARL

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tive regulation will hurt energy providers like Midwest Generation, killing jobs in a fragile economy. "Left unchecked, EPA's actions would have a devastating impact on jobs, U.S. competitiveness, and domestic energy prices," Representative Fred Upton (R-Mich.), chairman of the House Energy and Commerce Committee, said on Apr. 7 after the House passed legislation he wrote forbidding the EPA from regulating greenhouse gases under the Clean Air Act.

Democrats and environmentalists, who vow to stop the Senate version of Upton's bill, say that the act not only protects human health but actually strengthens the economy and more than pays for itself.

So, which is it?

The Clean Air Act, originally enacted in 1970, has been around long enough to allow for heavy-duty number crunching. By sharply reducing pollution from cars, factory smokestacks, and power plants, the law has saved thousands of lives a year and reduced the prevalence of asthma, emphysema, and heart disease, according to a pair of congressionally mandated EPA cost-benefit studies issued in October 1997 and this past March. The gains are not free; the EPA estimates that in 2010 compliance with the Clean Air Act required industry expenditures of $53 billion. Monetizing the corresponding benefits—things like extending life spans and avoiding hospital stays and sick days from work—produces a figure of $1.3 trillion. By the government's measure, therefore, the act's benefits exceed its costs by a factor of 25 to 1.

"The economic case is pretty convincing," says William K. Reilly, a senior adviser to the private equity firm TPG Capital. Reilly, a Republican who headed the EPA during the George H.W. Bush Administration and co-chaired President Barack Obama's commission on the 2010 Gulf of Mexico oil spill, points out an additional byproduct of the Clean Air Act: the growth of the environmental technology industry. Cleantech, comprised mostly of small businesses, generated $282 billion in revenue and supported 1.6 million American jobs in 2007, according to the EPA.

Environmentalism is not pain-free, nor are the politics around it simple. In mid-May, a labor union that normally backs the Obama Administration an-

By the government's measure, the Clean Air Act's benefits exceed its costs by a factor of 25 to 1

nounced that it would join with industry giant American Electric Power to lobby Congress to delay the EPA's planned imposition later this year of stringent new rules restricting emissions of mercury, lead, arsenic, and acid gases by coal-fired power plants. The facilities that would be affected emit some 386,000 tons of toxic air pollution a year. That makes them the country's largest industrial source of such contamination. Exposure to these pollutants can cause birth defects, as well as lung and heart illnesses.

Edwin D. Hill, president of the 725,000-member International Brotherhood of Electrical Workers, appreciates the hazards, but said in a May 16 statement that unless utilities were given an extra five or six years to modernize or close their oldest coal plants, about 50,000 workers in power, mining, and railroads would lose their jobs. The EPA concedes that its forthcoming mercury and air toxins rule (which the agency is under court order to issue) would cost industry nearly $11 billion a year in estimated compliance expenditures. Utilities, unsurprisingly, warn that the cost figure would be much higher. On the other side of the ledger, the EPA has estimated that the monetized value of health benefits from reduced mercury and other air toxins would far exceed expenditures.

All of which brings us back to Chicago's Fisk and Crawford power stations. Aggressive EPA action—on either greenhouse gases or mercury and more terrestrial pollutants—would present owner Midwest Generation with a dilemma: Are the antiquated plants worth expensive upgrades, as opposed to just shutting them down? The facilities directly employ a total of 200 people.

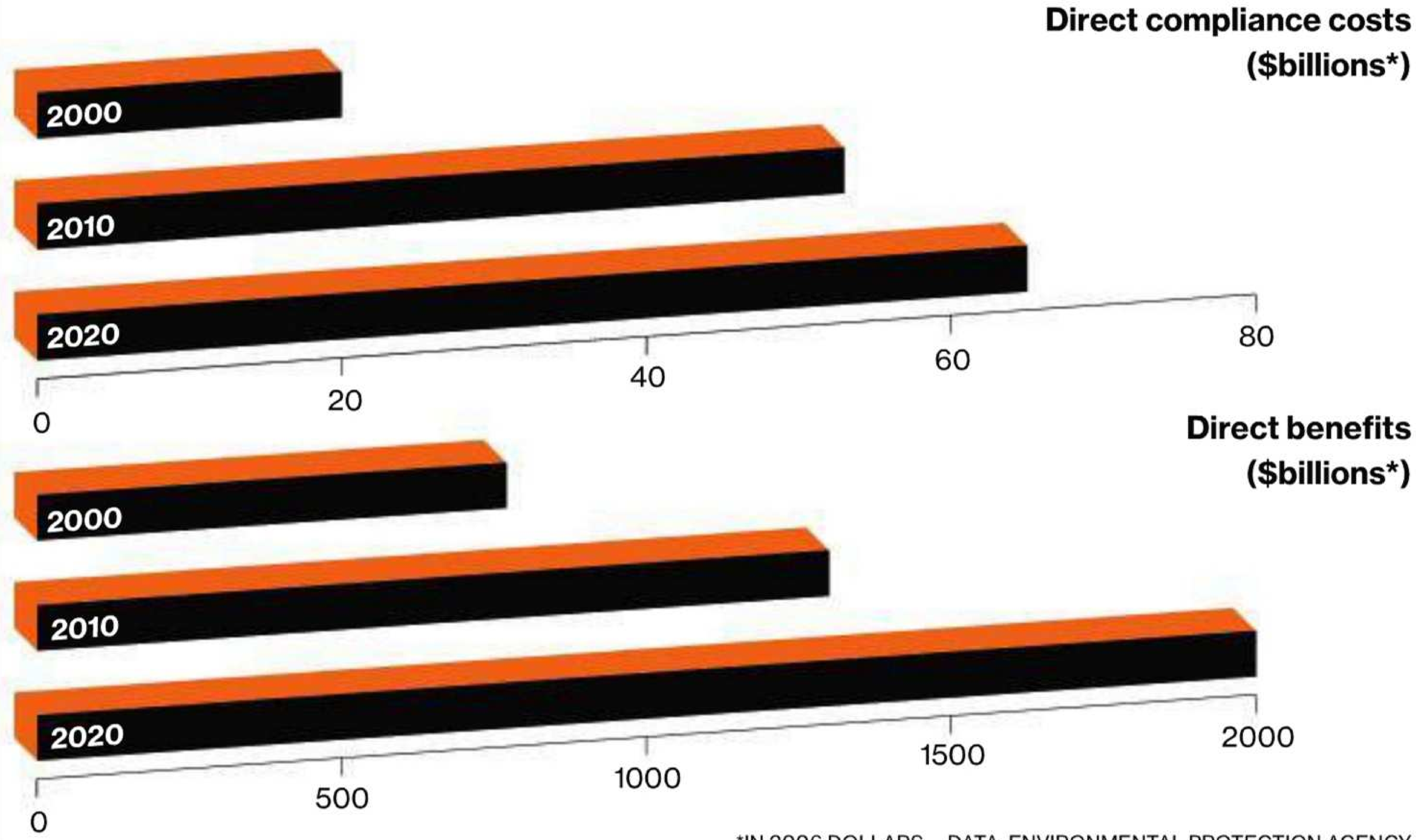
"We think we are well-positioned to comply with what the EPA is prepared to do on mercury," says McFarlan, the company spokesman. Beyond that, however, Midwest Generation has "not made final capital investment decisions." Those jobs, in other words, could be in jeopardy.

"The employment question is real," says the NRDC's Henderson. "The question is whether we want to preserve ancient plants that are making people sick—and costing us money for hospital stays—or we want to get to work on training workers for the jobs of the future in cleaner energy production and renewables."

That suggests an alternative to the traditional view of environmental enforcement as a cruel choice between employment and breathable air. The Clean Air Act can serve as a goad to generating better jobs in more innovative technologies—and as a mechanism to reduce health-care costs. The benefits seem worth the price. B

The Economics of Regulation

Monetizing the effects of the anti-pollution law



*IN 2006 DOLLARS DATA: ENVIRONMENTAL PROTECTION AGENCY

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Bloomberg VIEW

The Fed's Fight to Keep Its Lending Secret ● Gold Glitters, Regionally

It's Time for the Biggest Bank of All To Practice Customer Service

Imagine that a friend with infinite resources gives you unlimited access to his bank account in exchange for a symbolic amount of interest, say 0.01 percent. Then imagine you can do as you please with the money, including lend it back to your deep-pocketed friend at a much higher rate of interest—and keep the difference as profit.

It sounds too good to be true, yet it's a pretty good analogy for the method the U.S. Federal Reserve used to rescue the financial system from collapse in 2008. The biggest U.S. banks—and some foreign ones—were given access to Fed lending programs at negligible rates and then used the money to, among other things, buy 10-year Treasury securities with yields between 2.05 percent and 4.27 percent. Altogether, the central bank committed $3.5 trillion to bailing out banks and restoring the flow of credit to a paralyzed financial system.

Astoundingly, in combination with the $700 billion Troubled Asset Relief Program and various other bailouts by the Treasury Dept. and the Federal Deposit Insurance Corp., this approach mostly worked. So why does the Fed continue to conceal the way taxpayer money was used?

On May 26, Bloomberg's Bob Ivry reported that in 2008, Credit Suisse, Goldman Sachs, and Royal Bank of Scotland each borrowed at least $30 billion from a Fed emergency lending program whose details haven't been disclosed to shareholders, members of Congress, or the public.

It was no simple task to uncover this $80 billion Fed initiative known as single-tranche open-market operations (ST OMO), which from March through December 2008 made 28-day loans to units of 20 banks that paid interest rates as low as 0.01 percent. Information about the program was buried in 27 of the more than 29,000 pages of data the Fed was forced to release under the Freedom of Information Act after a request for disclosure was fought all the way to the Supreme Court.

The Fed claims, with some justification, that it's never been more open, giving pride of place to Chairman Ben S. Bernanke's big press conference on Apr. 27. Openness is different from transparency, however. While it's true the central bank has released a trove of data concerning its lending facilities during the 2007-09 crisis, it has never done so voluntarily.

There's a lot more to be done. Specifically, the Fed should make public the bank-supervisory memos from the period that preceded the popping of the credit bubble. Determining which signs and portents were missed, ignored, or misinterpreted will help regulators and Congress—and the Fed itself—avoid similar mistakes in the future.

The Fed's emergency policy of funneling money into the banking system has been followed by a post-emergency policy of quantitative easing, which amounted to funneling even more money into that same banking system. This has increased the threat of inflation and weakened the dollar. More disclosure would force central bankers to tell us how they plan to address these unintended consequences and deepen public appreciation of an independent Fed's beneficial role for all Americans.

When Gold Glitters, It's Not Always as a Warning

Have you been asked about gold lately? Has someone tried to explain to you that the precious metal's 27 percent increase in dollar terms during the past year signals ominous things? Runaway inflation, economic panic, infinite instability...

Instead of wasting your breath, direct the concerned party to a corner of the report released May 19 by the World Gold Council, the gold-mining industry's main trade group. Buried amid the standard report-ese is a statistical review of worldwide gold demand in 2011's first quarter. The data show that gold's ascent is being driven by extraordinary demand from India and China, where rising prosperity is making it easier for millions of people to buy gold in all its forms, particularly jewelry.

The WGC estimates that Indian households own more than 18,000 metric tons of gold, the largest holding on the planet. (U.S. official gold reserves total about 8,100 metric tons.) Indian consumers aren't done buying; in this year's first quarter they purchased an additional 206 tons of gold jewelry and 85 tons of gold bars and coins. And China's appetite is growing rapidly and could soon overtake India's.

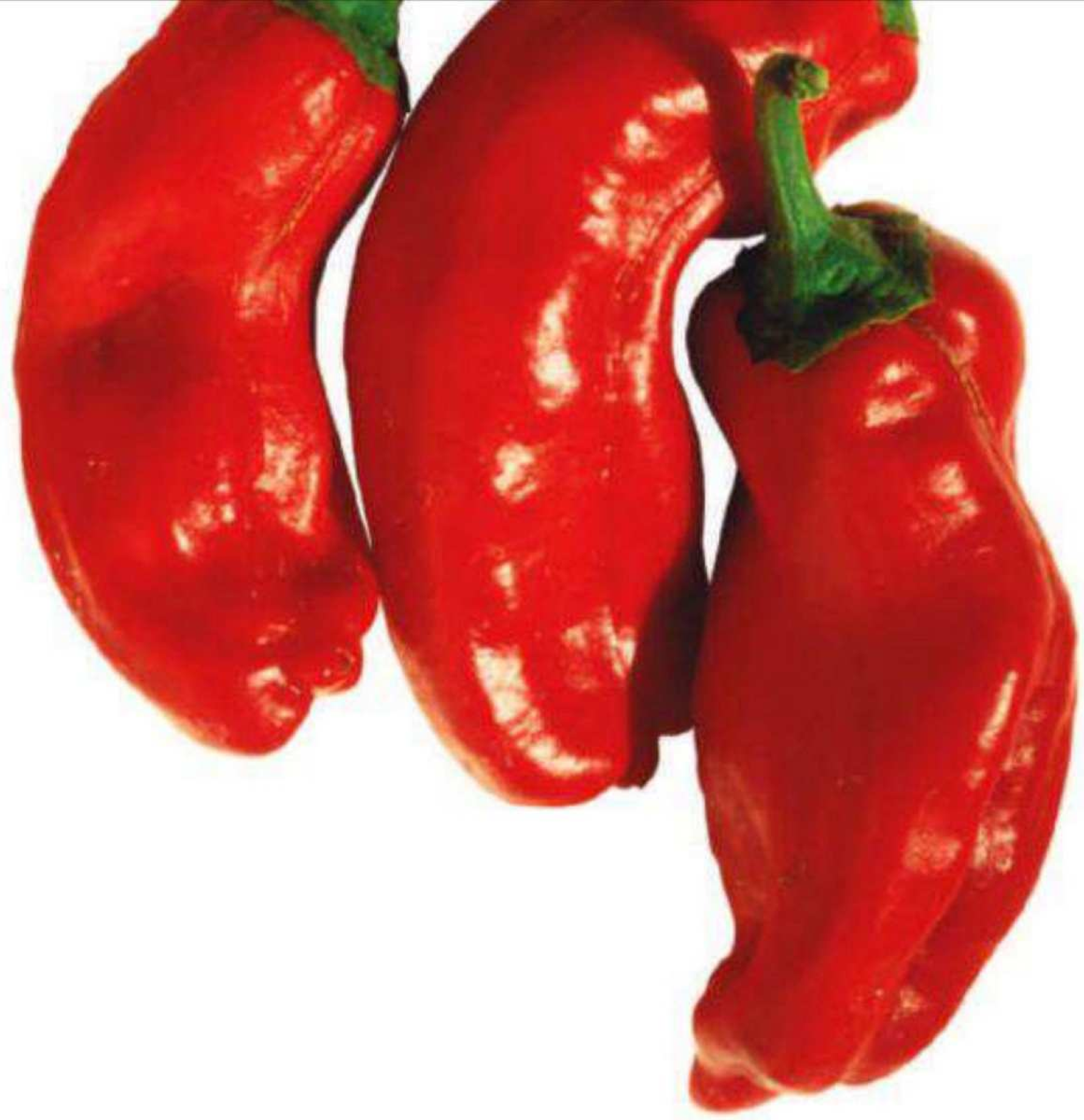
To come at the demand another way: If you strip out Chinese and Indian purchases, the rest of the world's hunger for gold isn't nearly so vibrant. Some new buyers have shown up; some prior speculators are cashing out. But a global flight to gold as a hedge against Armageddon doesn't appear to be taking shape.

This is not the company line of China National Gold Group, the country's largest gold mine. Earlier this month, President Sun Zhaoxue predicted that gold prices will stay high because of the dollar's depreciation and "intensifying geopolitical risks." His measured version of the safe-refuge thesis can be heard in much shriller tones on late-night American advertisements for gold coins.

Yet price surges for gold don't always reflect genuine fears and the need for disaster-proof investments. And gold's price may continue to climb this year. A recent Bloomberg News survey of 31 analysts, investors, and gold-mine operators found respondents, on average, predicting a year-end price of $1,750 an ounce, up significantly from recent levels of about $1,530. If such a rise occurs, however, it's likely to reflect new global demand for the shiny commodity rather than a farsighted warning to the world's central bankers. Ⓑ

▶ *To read Jonathan Alter on education reform and Daniel Goleman on the magic of laissez-faire bosses, go to: Bloomberg.com/view*

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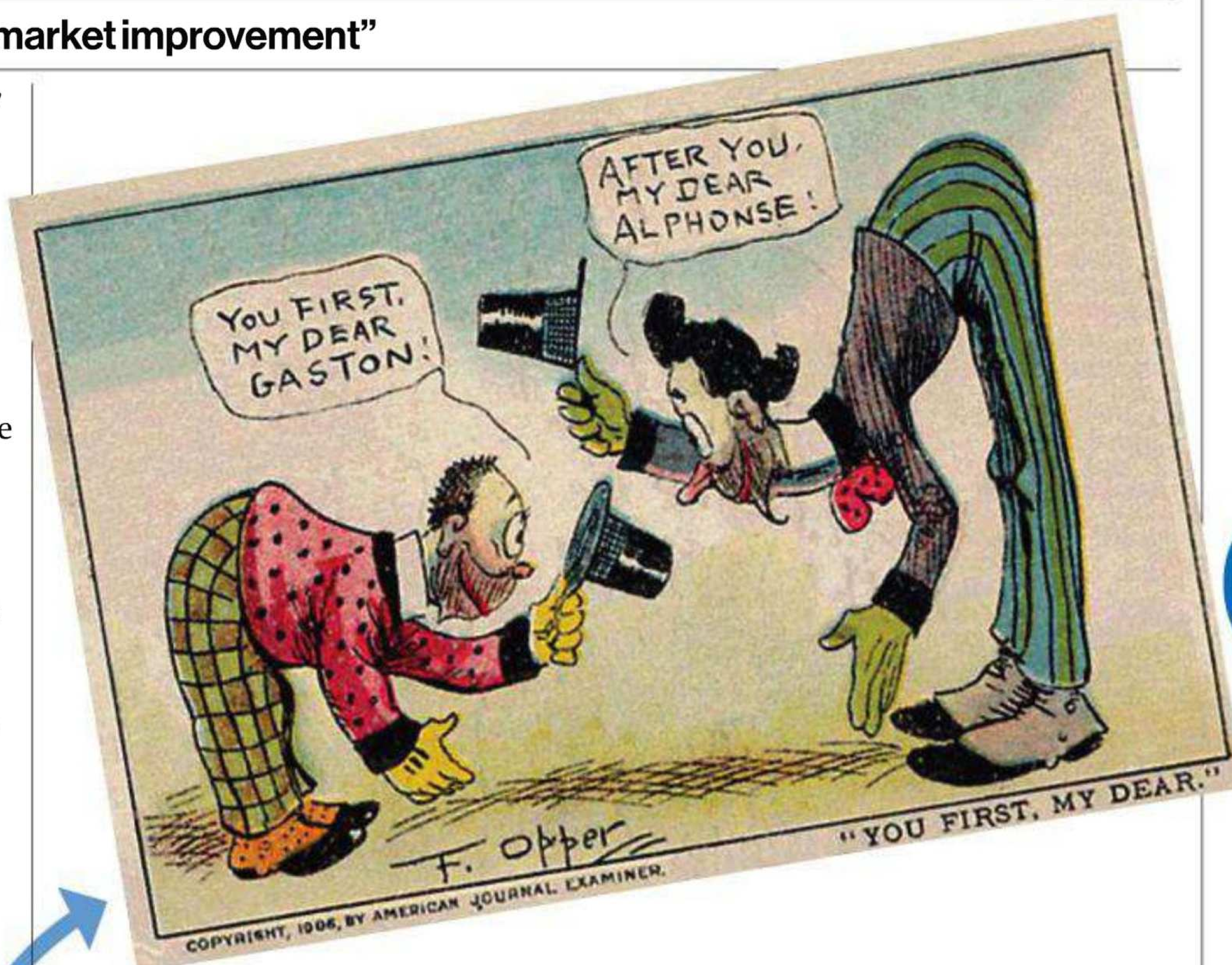
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Global Economics

The U.S. Economy's 'You First' Problem

▶ **The latest indicators show consumers and companies are in an anxious, wait-and-see mood**

▶ **"There's been almost no job market improvement"**



COORDINATION FAILURE

In 1901, William Randolph Hearst's *New York Journal* launched a cartoon featuring two overly polite friends named Alphonse and Gaston. Each insisted with conspicuous courtesy that the other go first. Amid elaborate bowing, scraping, and *après-vous*-ing, Alphonse and Gaston never managed to make it through an open doorway.

Now, 110 years later, economists have a name for the Alphonse and Gaston routine that's hobbling the U.S. economy: "coordination failure." Companies won't hire because customers won't spend. Customers won't spend because companies won't hire. This stare-down has been going on since approximately December 2007, when the worst slump since the Great Depression took hold. Many Americans would like someone to make a move so they can get back to prosperity. Yet they've lost confidence in the actions that were designed to build confidence and restore growth—namely, near-zero overnight interest rates, the bailout of the financial system, a weakening dollar, and stimulus measures that add to the federal budget deficit and the national debt.

The latest downer: Housing prices in 20 big U.S. metropolitan areas fell in March to their lowest level since 2003, according to the S&P/Case-Shiller Index released on May 31. "I wouldn't be surprised to see prices continue to fall this year and maybe into next year," says Paul Dales, a senior U.S. economist at Capital Economics in Toronto. The Conference Board announced on May 31 that its measure of consumer confidence fell to 60.8 in May from 66 in April. (It was more than 100 before the recession.) Manufacturing growth is slowing, too, according to the latest data released on June 1. The factory index of the Institute for Supply Management fell in May by the most points since 1984.

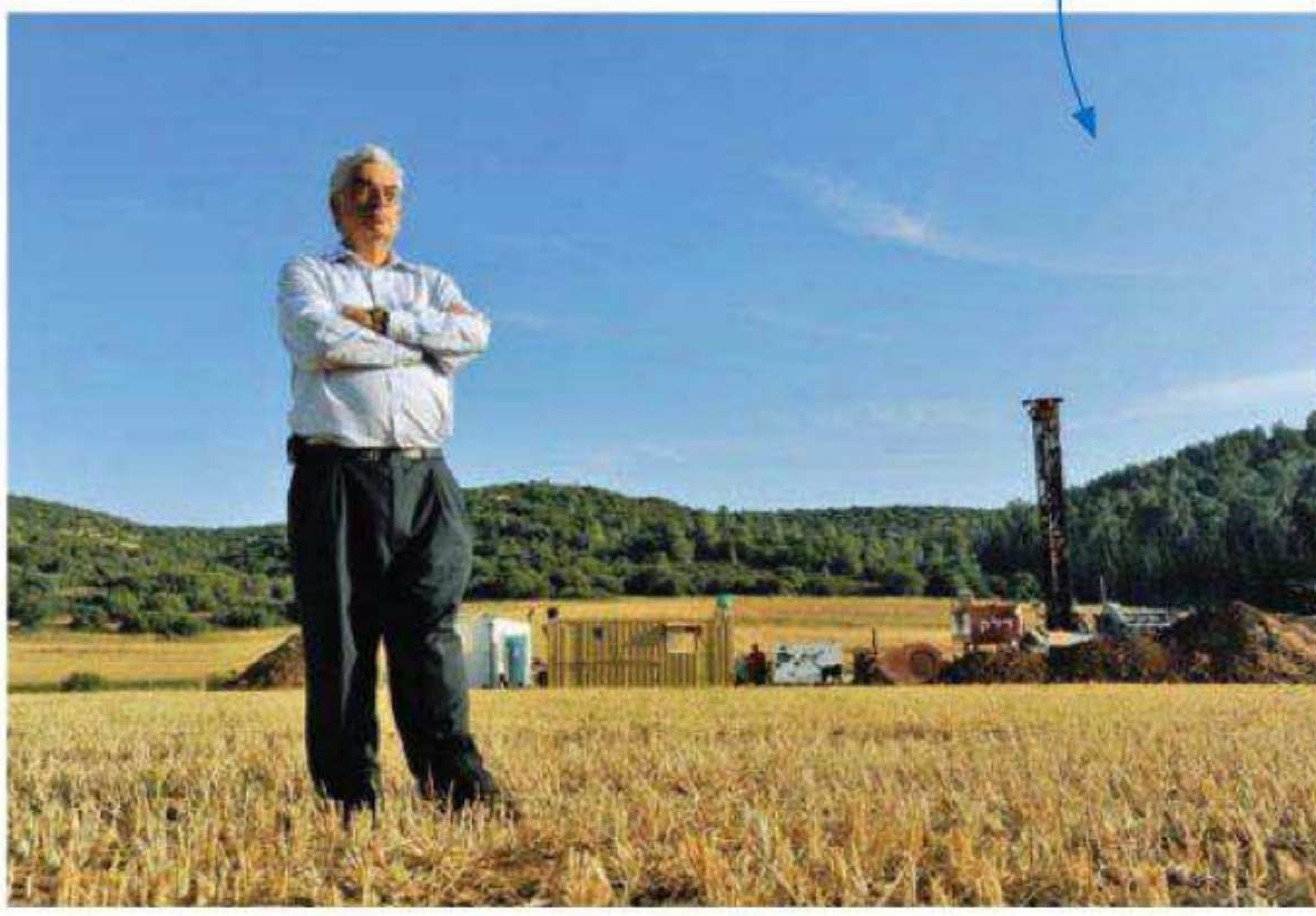
In Boulder, Colo., Michael R. Englund, chief economist at Action Economics, hears the grumbling on the sidelines at his children's sports matches. "The whole country's talking about monetary policy, and it's pretty hostile," says Englund. "They're asking me, 'Are we still going to have a dollar in five years?'" From Scottsdale, Ariz., retired tech executive and Tea Party activist Arch McGill says people fear government: "The elite need to visit the West, Midwest, and South to get an understanding of the mood of the people—they are pissed, buying guns and food for the coming battle."

The tension between the elite and Main Street is not going away: Economic decision-makers in Washington, headed by Federal Reserve Chairman Ben Bernanke, continue to defend the bailouts and easy money as necessities for economic recovery. In a little-noticed remark at his April press conference, the first by a Fed chairman, Bernanke said that in his view the main risk is not doing too much, it's doing too little. In past crises, he said, it "might be that policy responses were not adequate... to get as quick a recovery as might otherwise have been possible."

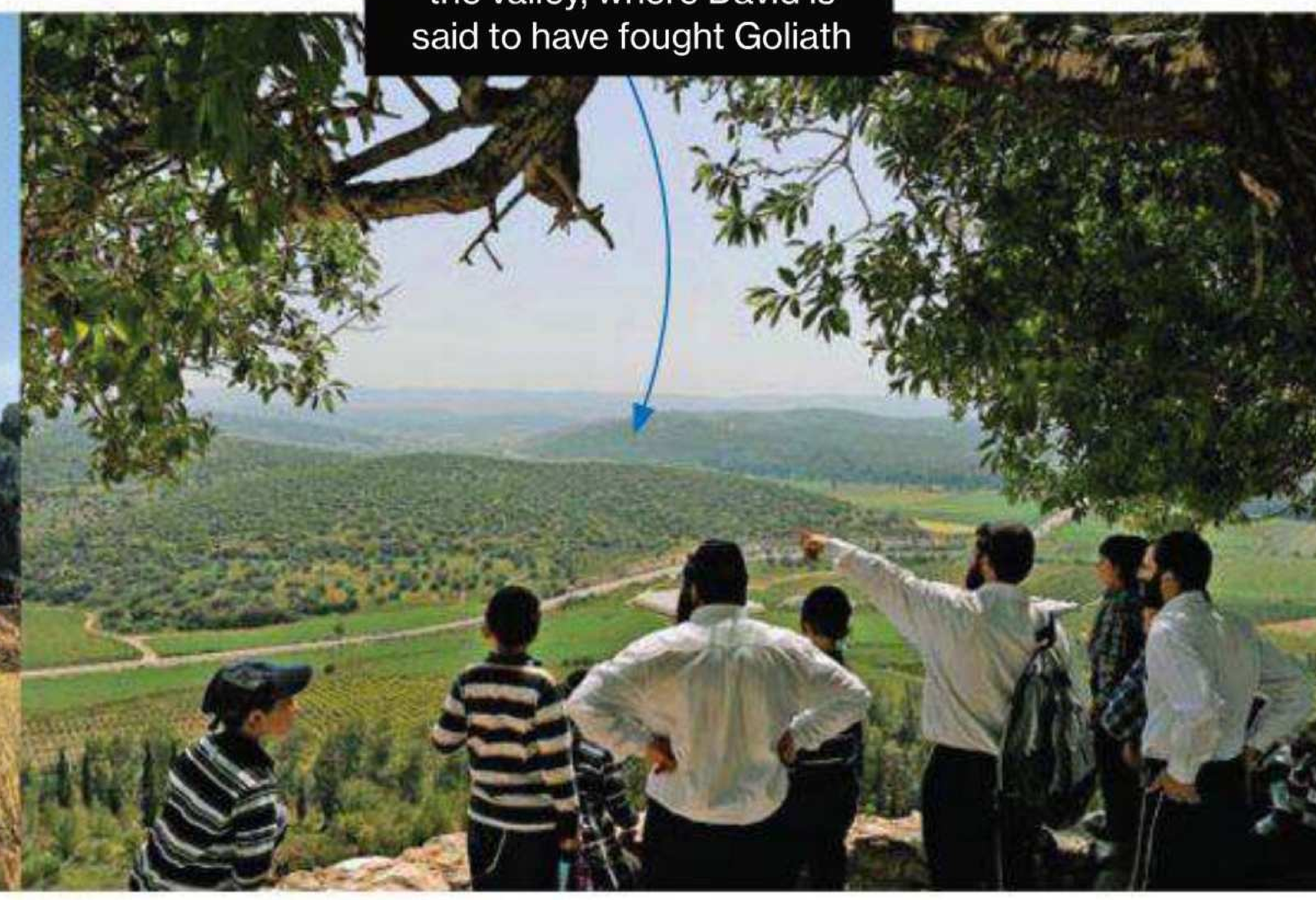
Just how or why expansions begin still isn't well understood after more than a century of research. The French economist Léon Walras (1834-1910), the founder of general equilibrium theory, speculated that an economy climbs back to full employment through a process called *tâtonnement*—French for the groping, trial-and-error strategy that mountain climbers use to find hand- and footholds on a

WorldMags

IEI's Vinegar says Israel's Elah Valley has major deposits of shale oil



Orthodox Jews overlook the valley, where David is said to have fought Goliath



PHOTOGRAPHS BY AHIKAM SERI FOR BLOOMBERG BUSINESSWEEK

rock face. As any rock climber knows, though, *tâtonnement* can lead to dead ends. Says Franklin M. Fisher, a microeconomist and professor emeritus at Massachusetts Institute of Technology who has studied Walras and his successors: "The notion that the economy will dig itself out isn't always true. Even if you know that the economy will sooner or later clean itself up, if that 'later' is awfully far away, you have to wonder."

The risk is that instead of steadily making its way back to full employment, the U.S. economy gets stuck in the current low-growth rut. Employers are sitting on their hands. True, they've stopped ditching workers: Layoffs and firings in March were tied for their lowest level of the past decade, at 1.2 percent of employment, according to the Labor Dept.'s Job Openings and Labor Turnover Survey. But companies aren't hiring, either. At 3.1 percent of employment in March, the hiring rate is barely up from the recession low of 2.8 percent. What's more, it's lower than the 3.8 percent level at the same stage of the last recovery, in late 2003. "If you already have a job, the labor market probably doesn't seem so bad, but if you're looking for a job, there's been almost no job market improvement over the last few years," says Michael E. Feroli, chief U.S. economist at JPMorgan Securities.

When people are out of work for extended periods, their skills atrophy, their contacts in the working world dry up, and their chances of reemployment diminish. Forty-six percent of the unemployed have been out of work for half a year or more, more than triple the usual proportion. Peter A. Diamond, the MIT economist who has been awaiting Senate confirmation of his appointment to the Federal Reserve Board for 13 months, wrote in February that with so much slack in the labor market, further fiscal stimulus can add jobs without raising inflation.

Not everyone is gloomy. The Standard & Poor's 500-stock index is hovering near its 2010 high after having doubled since its March 2009 low. Yet the recent drop in Treasury yields, to below 3 percent on the 10-year note from a recent peak of 3.7 percent in February, reflects increasing skepticism about the outlook for growth. The National Federation of Independent Business's index of small business owners' optimism fell in March and April, partially reversing a gradual uptrend that began in early 2009. "The 'get-up-and-go' usually present in the small business sector after a recession 'got-up-and-went,'" the organization announced on May 10. Corporate Executive Board, an Arlington (Va.)-based research and advisory company, said on May 31 that hiring expectations at large companies dipped in the first quarter for the first time since its survey began in October 2009.

The public is no more buoyant. "I think we are stuck in a vicious circle," says Fred Crawford, CEO of AlixPartners, a Southfield (Mich.)-based business consulting firm. "There's a pervasive feeling of uncertainty." The Chicago Booth/Kellogg School Financial Trust Index, based on a survey of the American public, fell in March to 20, plumbing the lows of 19 and 20 reached in the depths of the financial meltdown of 2008-09.

There are really two stalemates here. In the economy, both consumers and businesses are waiting for a stronger signal of better times ahead. In politics, the system is deadlocked over whether the economy needs more help from the government or less. A Nobel prize goes to whoever can end this routine and get America growing again.
—*Peter Coy, with Bob Willis*

***The bottom line** The key players in the U.S. economy —big companies, small businesses, and consumers— are all searching for a way to move forward.*

1.1

MILLION

Number of millionaire households in China as estimated by Boston Consulting Group. That's a 31 percent gain since the firm's 2010 report. China ranks third behind the U.S. and Japan.

DATA: BOSTON CONSULTING GROUP

WorldMags



Children play on wet tarpaulins set up by critics to simulate an oil slick



Workers at IEI's drilling site in Adullam, an important grape-growing region

Energy

Looking for an Oil Boom In Israel's Napa Valley

▶ An American company tries a new technique to reach oil shale

▶ "Israel is not the place for this kind of industry, especially this part"

In a golden wheat field set among the green hills of Israel's Adullam region, Harold Vinegar gestures to a drilling rig as it pulls up core samples of oil shale from some 400 meters (1,312 feet) down. "Israel has one of the largest deposits of oil shale rock in the world, enough to produce 250 billion barrels," says the 62-year-old geologist, who spent three decades at **Royal Dutch Shell**, eventually becoming Shell's chief physicist. "Saudi Arabia has reserves of 260 billion barrels. Most people don't realize yet that Israel has the potential to be one of the world's major oil producers."

They sure don't. An old joke has Moses making a wrong turn after leaving Egypt and leading the Israelites to the only land in the Middle East without oil. Over 400 wells have been dug in Israel over the past six decades with little success, some by wildcatters claiming divine guidance from scripture and rabbinical advisers.

Vinegar, who moved to Israel from the U.S. almost three years ago to become chief scientist for a company called **Israel Energy Initiative**, is leading an effort to find–and extract–the oil Israelis have long sought. Israel's sedimentary rock contains solidified hydrocarbons called kerogen. If heated to 600F the kerogen release their oil, as well as gas. IEI, a branch of the U.S. telecom company **IDT**, may have found a cost-effective way to heat the kerogen enough to bring the oil to the surface. This vision has entranced Israeli officials and investors including **News Corp.** Chairman Rupert Murdoch, British financier Lord Jacob Rothschild, and hedge fund manager Michael Steinhardt.

The dream of an energy-independent Israel has taken a giant leap forward since the 2009 discovery of substantial natural gas fields off its coast. The strategic value of those finds was confirmed when the uprising in Egypt disrupted its gas exports to Israel. Since Israel must import all its oil and coal and 70 percent of its gas, tapping the oil shale successfully could be a game-changer for the Jewish state.

First, though, Vinegar has to prove the oil can flow easily. The traditional way to extract shale oil is through open-pit mining, with production costs ranging from $70 to $100 a barrel. Vinegar says a more economical alternative with less damage to the landscape involves slowly and uniformly heating rods made of molten salt that are sunk into the shale deposits. Heat from the rods, which are kept at up to 600F, spreads through the shale slowly, over three to five years. The resulting oil and gas are then pumped to the surface. Vinegar is a pioneer in developing this technology, which he says could produce oil for as low as $35 a barrel.

Investors in the oil shale project include Rupert Murdoch and hedge fund manager Michael Steinhardt

Israel's shale oil deposits have remained untapped largely for geopolitical reasons. "None of the major oil companies are willing to do business in Israel because they don't want to be cut off from the Mideast supply of oil," says Howard Jonas, chief executive officer of IEI's corporate parent, IDT, in Newark, N.J. Investor excitement over the shale ventures has helped push IDT's stock, which fell to 66¢ a share in late 2008 on its struggling prepaid calling-card business, to about $30.

By yearend, IEI plans to start a small pilot project in Adullam to show how the conversion from kerogen to oil works onsite. That prospect has alarmed environmentalists, who argue that IEI risks contaminating Israel's main aquifer. Adam Teva V'Din, head of the Israel Union for Environmental Defense, has petitioned the High Court of Justice to halt the pilot, arguing the government wrongly granted IEI a permit under a 1952 petroleum law that does not apply to unconventional extraction methods.

Concerns about aquifer contamination have dogged other shale oil efforts, including an IDT project in Colorado. Vinegar says contamination is not an issue in Israel because an impermeable, 200-meter-thick rock layer separates the Adullam oil shale deposits

from the aquifer. Israel's National Infrastructures Ministry says IEI has a license solely for the pilot project, and commercial development will proceed only after the environmental impact has been evaluated.

These reassurances don't satisfy all the residents of the Adullam region's grape-growing Elah Valley, which is marketed as Israel's answer to California's Napa Valley. On Apr. 22 a protest took place in an archeological park amid 2000-year-old ruins. It featured children playing in a pool of "oil" simulated by black plastic tarpaulins. "They are planning an experimental, hazardous, and dirty oil industry," says Orit Skutelsky an ecologist with the Society for the Protection of Nature in Israel. "Israel is not the place for this kind of industry, especially this part of it."

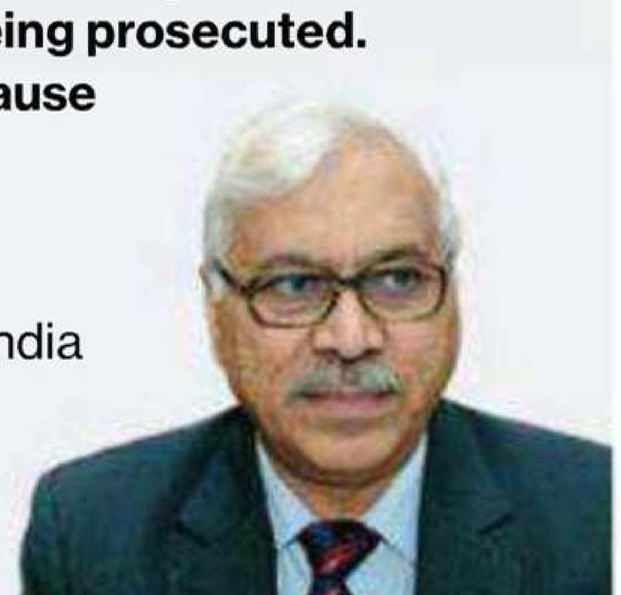
If the pilot project is allowed to proceed this year, says IDT's Jonas, oil could be produced as early as 2017. Shale oil expert Jeremy Boak at the Colorado School of Mines believes the project "is something they can achieve and make profitable at the kind of oil prices we have right now." Boak also says that since the technique releases natural gas as a byproduct, the gas can be used to heat the rods and keep costs down.

For investors such as Steinhardt, a leading philanthropist for Jewish causes, the possibility of an energy-independent Israel is as much of an attraction as any possible profit. The hope, says Steinhardt, also IEI's chairman, is "that this will turn into something very important for the state." —*Calev Ben-David*

The bottom line *New technology could heat Israel's shale deposits into 250 billion barrels of oil. Environmental concerns linger.*

Quoted

"Some people are entering politics because they see it as a way to make money, others think being elected means they will avoid" being prosecuted. "That's the root cause of corruption."
—S.Y. Quraishi, Chief Election Commissioner of India





Willie, who has silicosis, is among some 300,000 ex-miners who could seek redress

Labor

Blowback From the Apartheid Era

▶ A court ruling frees ex-miners with silicosis to seek compensation

▶ "It's hard to breathe. I can't manage to work again. I need help"

Toto Willie has little to show for a decade's work in **Anglo American**'s gold mines: a store selling potato chips and kerosene, run from one of the three rooms in his tin shack, and a 1985 Toyota station wagon. Willie's wife, Nowest, looks after a neighbor's two babies to supplement the few hundred rand the family earns monthly from their store.

Willie also has a medical certificate showing he has silicosis, a scarring of the lungs caused by prolonged exposure to the silica dust released by some kinds of gold mining. Willie and others with the disease worked in South African mines now run by such companies as **Gold Fields**, **Harmony Gold Mining**, and **AngloGold Ashanti**, a spinoff of Anglo American. "It's hard to breathe," Willie, 50, says at his home in Happy Valley, a trash-strewn shantytown near Cape Town, as he pulls the certificate from a worn folder. "I can't manage to work again. I need help."

South Africa's highest court on Mar. 3 ruled that ex-miners such as Willie can seek redress from companies that during apartheid depended on cheap black labor to work the world's deepest mines. Mining companies may face a liability of as much as $100 billion, Leon Esterhuizen, an analyst at RBC Capital Markets in London, said in a May 6 note to clients. He bases this estimate on the assumption that 300,000 potential claimants could each sue for at least 2 million rand ($294,000). "The whole risk really depends on whether these people putting these claims up can prove negligence by the mining companies," he says. Ultimately, a settlement at a significantly lower level is likely, he says.

In the ruling, South Africa's Constitutional Court said workers who qualified for state benefits for occupational disease could also seek compensation from their former employers. It ruled that Thembekile Mankayi, who contracted silicosis and tuberculosis after working at the Vaal Reefs mine, once owned by Anglo American, can sue for compensation on top of a one-time 16,316-rand ($2,320) payout, which he received from the government for contracting a work-related illness. Mankayi died before he could sue. "The judgment potentially opens the floodgates for claims," says Warren Beech, a mining lawyer at Webber Wentzel in Johannesburg who is not involved in the litigation.

"We're trying to get our arms around what the potential might be," Gold Fields Chief Executive Officer Nicholas J. Holland told investors on a May 19 call. "It's speculative at this stage to assume that there's going to be

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Global Economics

Aston Martin's car for the masses page 26 ▶



Tom Keene's EconoChat

Tom talks with **Ed Yardeni,** president of Yardeni Research, about debt, growth, housing, and the economy

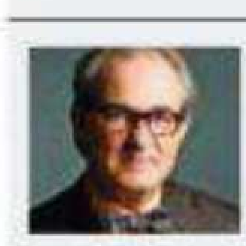
What flavor of crisis are we having right now?
All in all, we are still trying to dig out from under all the debt that accumulated over the past decade.

The 10-year yield is now around 3 percent. What does that say about expectations for slow growth?
The bond yield to me is the market's assessment of what the growth rate is for nominal GDP on a year-over-year basis, and 3 percent is pretty pathetic.

We come to June with 9 percent unemployment. What portion of that is structural, and what is cyclical?
There's a structural component. There's still a lot of people who were employed in housing industries who just haven't moved on.

It seems the next hurdle for housing is straightening out the paperwork.
No, it's not. It's mold and mildew. You are right that there's all this paperwork. It takes forever to foreclose on a house, and it's not even clear if you've got the right papers. So the buyer might say, well, I'm not convinced that everything's legal here. And so houses are on the market that are owned by the banks, they're sort of in limbo, and they're starting to deteriorate in quality. It's a major problem.

When do we get back to normal with housing?
Look, it could be seven, it could be 10 years, all total. Ⓑ



Keene hosts Bloomberg Surveillance *7-10 a.m. ET on 1130AM in New York and nationally on SiriusXM 113.*

a huge number of suits or whether in fact those suits will even be successful." While AngloGold has made no provision for damages, it has "fully complied with statutory and regulatory requirements," the Johannesburg-based company said in an e-mailed response to questions. Harmony said in an e-mail that it's too early to determine liability. Anglo American is fighting a separate silicosis damages suit that was filed by 18 miners in 2004 and is due to come to trial next year. Four of those workers have died. "Anglo American believes that the claims against it are ill-founded," Sir John Parker, the company's chairman, said at its annual meeting in London on Apr. 21.

A study published in 1998 in the Stockholm-based *Journal of Mineral Policy, Business and Environment* estimated that 196,560 former miners from South Africa and 84,240 from neighboring states, who worked in South Africa, had occupational lung disease and had not been compensated. Under the institutionalized racial discrimination of apartheid and the whites-only-vote era that preceded it, mining companies employed workers from the poorest communities. "Mine workers, and black mine workers in particular, were really treated like a commodity," says Richard Spoor, Mankayi's lawyer. "A steady supply of healthy young men came to our mines to be used, consumed, and, once they were broken, discarded."

In 2003, Spoor, a human-rights lawyer, reached a 490 million rand settlement with **Gencor** after it was sued by South African workers from asbestos mines it controlled. Spoor plans to file a series of cases on behalf of miners with occupational lung disease.

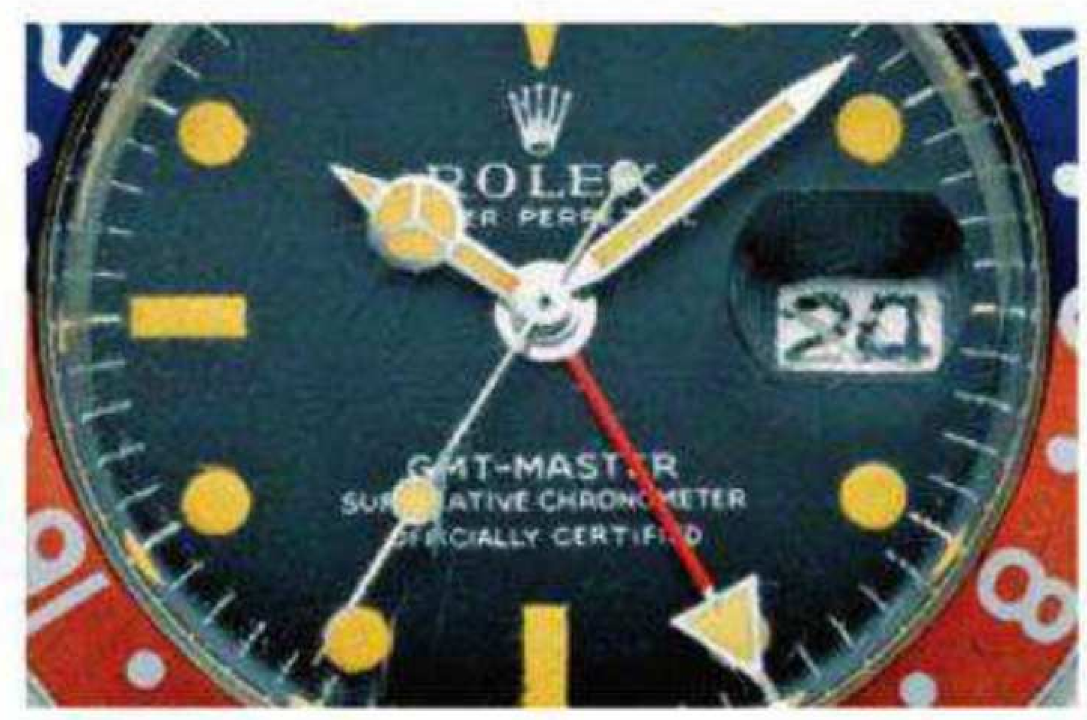
Willie says his employer never supplied him with a mask and paid him two weeks' wages when he was told in 1995 that his job was terminated. The government plans to talk with the mining companies about securing better payouts for workers. "Compensation is not adequate," says Mineral Resources Minister Susan Shabangu. "In fact, it's a real joke."

The Chamber of Mines of South Africa says its members are improving working conditions and new silicosis cases should be eradicated by 2014. The companies have worked to pump more compressed air from the surface into mining shafts to improve ventilation and have installed better systems to monitor dust levels. Spoor says mining companies have known for decades that silicosis is preventable yet were reluctant to incur the expenses of providing adequate underground ventilation, which makes them liable for damages. "The million-dollar question is how big that settlement will be," Esterhuizen says.
—*Mike Cohen and Carli Lourens*

The bottom line *Some of the world's biggest gold mining companies may pay a total of up to $100 billion for their apartheid-era treatment of miners.*

Exchange Rates

The Swiss Can Barely Afford Their Currency



▶ The ever-stronger franc drives up the price of Swiss goods

▶ "It's a dangerous situation because there is really nothing we can do"

Silvy Gillhausen, a saleswoman at the **Zett Meyer** watch store on Zurich's Bahnhofstrasse, senses trouble when clients from abroad pull out their phones. "Some customers come in with prices saved in their cell phones to compare them with ours," she says, standing near a display of **IWC** and **TAG Heuer** watches costing as much as 10,900 Swiss francs ($12,930). "Even when we give them 10 percent off, it's still cheaper in their home country."

The crisis in the euro zone has sent investors scurrying to the safety of the franc, driving it up 25 percent against the euro in the past two years. Almost half of the Swiss corporate executives surveyed by the central bank said in January and February that they "experienced negative effects" from the strong franc. Shops such as Zett Meyer that cater to the tourist trade feel the pain. So do exporters. "If you have loads of euro sales and lots of Swiss franc

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Global Economics

costs, you're getting killed," says Jon Cox, head of Swiss equity research at Kepler Capital Markets in Zurich. Converting euro sales into francs reduces reported results.

While multinationals such as **Nestlé**, the world's largest food conglomerate, can mitigate losses by moving production abroad, smaller Swiss firms are running out of ways to cut costs. "It's a dangerous situation because there's really nothing we can do," says Peter Widmer, president of Swiss Export, a Zurich-based lobbying group. Thierry Stern, president of deluxe watchmaker **Patek Philippe,** said in March that Switzerland may be better off adopting the euro. "It's a nightmare for everybody," he said. "We have to adapt."

Mopac, which makes packaging material for food companies, cut wages by about 10 percent for its 260 workers in February because of the franc. The company adjusts wages every three months depending on the exchange rate, says Hans Hartmann of the trade union Unia, which represents employees in a complaint against the company. "Exchange rate fluctuations are a risk that should be taken on by the company's owner," he says. Mopac will restore wages to pre-February levels if the euro-franc rate returns to what it was in 2009, says Chief Executive Officer Rainer Füchslin. "If we hadn't cut wages, we would have had to move our production to the euro zone," Füchslin says. "We did this for our employees."

Jürg Zürcher, manager of the **Sunstar Parkhotel** in Davos, says some tourists from the U.S., the euro zone, and Asia are opting for cheaper rooms in countries such as France or Austria. "We concentrate our marketing on Switzerland rather than the European market," says Zürcher.

When visitors do come, they often spend less. Architect Mauro Portela, 43, and lawyer Fred Ferreira, 25, from Brazil said they were surprised by the high prices. "We didn't know the differences between the prices in different countries in Europe," says Portela, who may reconsider his plan to buy a Cartier watch in Switzerland. "All of Europe is expensive, but especially Switzerland." Ⓑ

—Matthias Wabl and Corinne Gretler

The bottom line *The Swiss franc's 24 percent gain against the euro since 2009 is squeezing local exporters and retailers.*

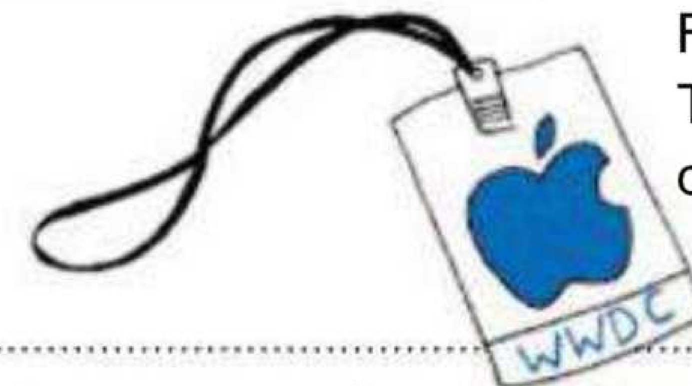
Events of note in the week ahead

Seven Days

by Ira Boudway

06

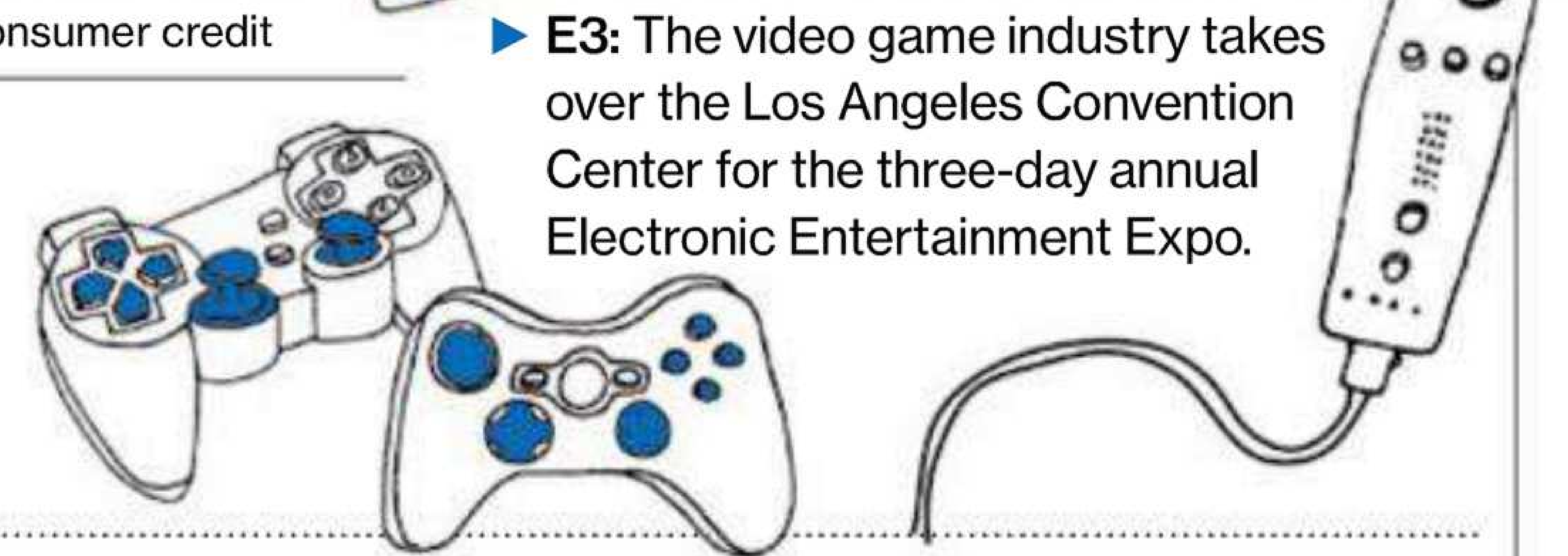
International Economic Forum of the Americas Conference of Montreal



▶ **Apple Worldwide Developers Conference:** Thousands of Web engineers and developers gather in San Francisco for the five-day showcase. This year, Steve Jobs will unveil the company's new cloud storage service.

07

U.S. consumer credit

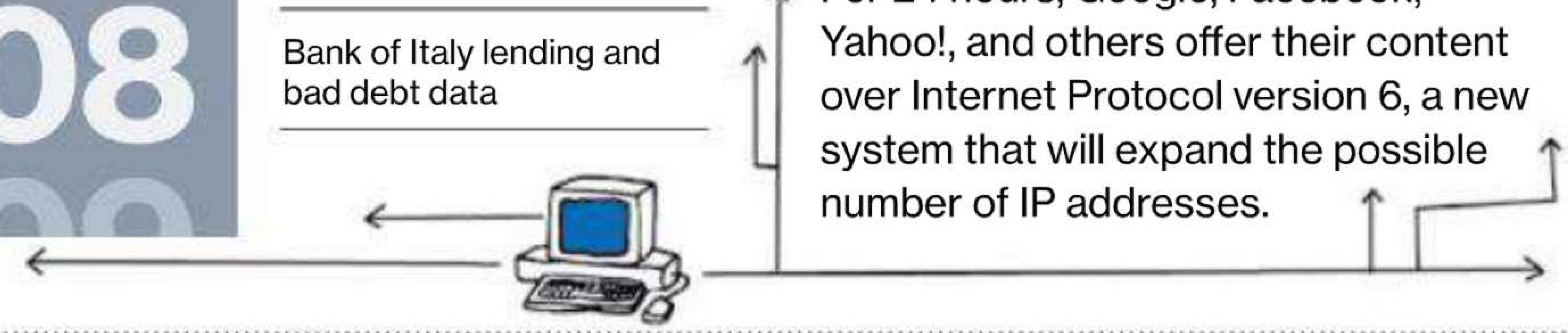


▶ **E3:** The video game industry takes over the Los Angeles Convention Center for the three-day annual Electronic Entertainment Expo.

08

Federal Reserve Beige Book

Bank of Italy lending and bad debt data

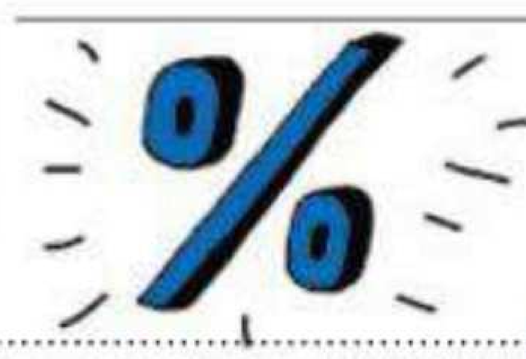


▶ **Next-generation Internet test drive:** For 24 hours, Google, Facebook, Yahoo!, and others offer their content over Internet Protocol version 6, a new system that will expand the possible number of IP addresses.

09

China's trade balance

Bank of England announces interest rate



▶ **Bonnaroo:** Manchester, Tenn., hosts the 10th annual four-day music festival. This year's lineup includes Arcade Fire, Eminem, the Black Keys, and Lil Wayne.



10

Canada's unemployment rate

Germany's consumer price index



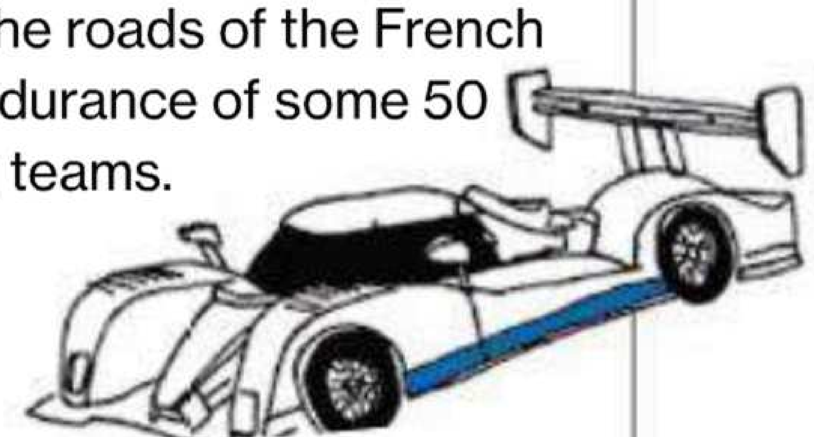
Lagarde inquiry: French judges decide whether to investigate Christine Lagarde, the Finance Minister and candidate to head the IMF, for her role in a 2007 legal settlement in favor of a political ally.

11

Belmont Stakes



▶ **24 hours of Le Mans:** The legendary auto race over the roads of the French city tests the endurance of some 50 cars and driving teams.



12

Tony Awards



▶ **Elections in Turkey:** Scandal and violence, including a bomb blast that wounded eight in Istanbul on May 26, have marred the runup to the vote.



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ILLUSTRATION BY JULIA ROTHMAN

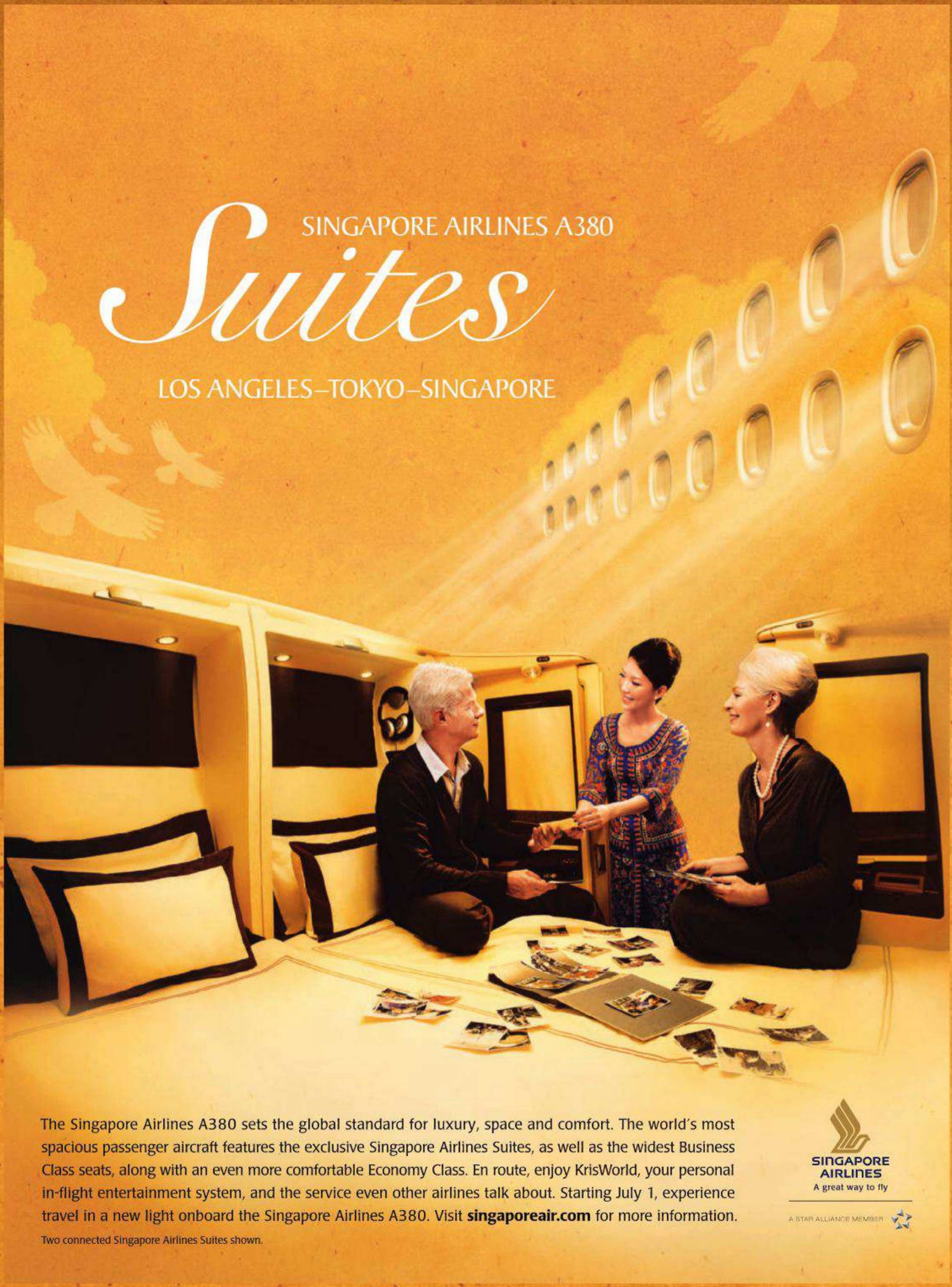
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2012 CLS 550 shown in Iridium Silver metallic paint with optional equipment. ©2011 Mercedes-Benz USA, LLC

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Two connected Singapore Airlines Suites shown.
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Contents ▶ Aston Martin bets on tiny urban luxury 26 ▶ Disney shorts keep *Toy Story* merchandise moving 27 ▶ Chevy's not-so-green plan to offset emissions 28 ▶ Why toys from China will cost more this Christmas 29 ▶ Briefs 30 ● Edited by James E. Ellis

Companies&Industries

A New Pricing Game for Drugmakers in Europe

▶ Germany's new rules tying pharmaceutical prices to greater efficacy is worrying companies

▶ "If it's a groundbreaking new product, we're ready to pay"

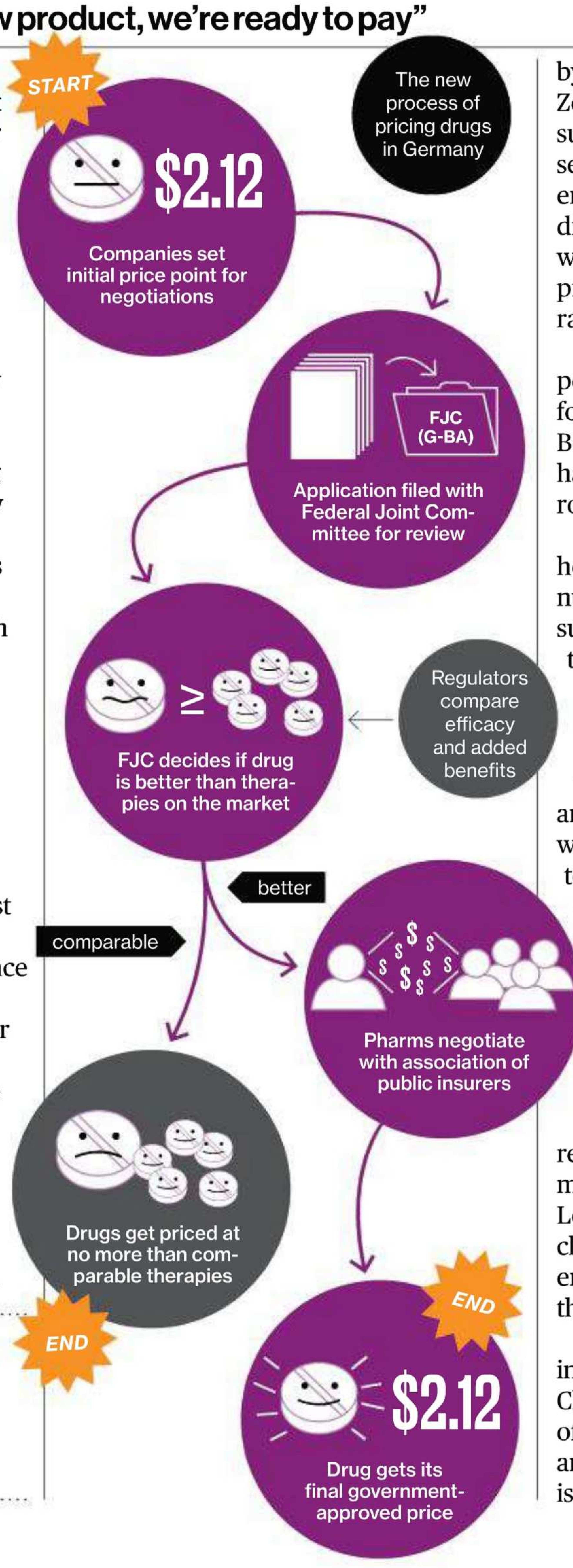
AstraZeneca recently set the price of its new Brilique blood thinner, which it hopes will become its next blockbuster drug, at €1.69 ($2.38) per pill in Germany. Whether it will be allowed to maintain that price in Europe's largest drug market remains to be seen. The British drugmaker, insurers, and German regulators are bracing for a yearlong battle over the medicine's value, the first test of a new pricing law in Europe's biggest economy.

What makes the legislation so wrenching for Big Pharma is that drug companies previously needed to show only that a drug was safe and worked better than a placebo. Now the onus is on companies to prove not just that a drug works but that it is actually worth more than older therapies. If a drugmaker can't convince German regulators that its compound has greater efficacy or additional benefits, then it cannot charge more than rival medicines already on the market.

It's the latest effort by a European nation to curb health spending, and AstraZeneca in January became the first to seek approval for a new drug under the revised process. "We have the chance to help design the system," says Claus Runge, AstraZeneca's vice-president for health-care affairs in Germany.

AstraZeneca has a lot at stake. More than half its $33.3 billion in sales last year came from drugs that will face generic competition by 2014. Brilique is expected to garner annual sales of $2.4 billion in 2016, according to the mean estimate of six analysts surveyed by Bloomberg. That would make it AstraZeneca's first blockbuster in years. But success depends on winning approval to sell the drug in the U.S., where the government does not negotiate prices for drugs used by Medicare patients. Elsewhere, AstraZeneca may also need to price the drug closer to the €2.25-€3.50 range it used in an internal study.

Regulators estimate the new law could help save Germany about €2 billion annually



What happens in Germany "is important for AstraZeneca, particularly for Brilique," says WestLB analyst Mark Belsey in London. The decision "will have a ripple effect on other major European markets like France."

Regulators estimate the new law will help save Germany about €2 billion annually. Pharmaceutical companies say such thrift may undermine their ability to recoup the cost of developing innovative drugs. John C. Lechleiter, chief executive officer of **Eli Lilly**, says pricing pressure in Europe is so worrisome that he has traveled to Berlin, Madrid, and London over the past year to meet with health officials about their regulatory overhauls. He told the U.K. Health Dept. that negotiations over a drug's value-based price may lead to delays in the introduction of new treatments, according to minutes of a meeting obtained by Bloomberg News. "Ultimately, for more medicines to come from our labs, the value of those medicines needs to be rewarded with prices and reimbursements that really reflect that," says Lechleiter. Lilly and others, he says, are closely watching AstraZeneca's experience in Germany to see how dramatically the environment has changed.

The new drug pricing law, passed in November, was a central element of Chancellor Angela Merkel's plan to ward off a shortfall in Germany's public insurance system this year. Health Minister Philipp Rösler coupled the

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Is Huntsman the "adult in the room"? page 34 ▶

nation's first price negotiations on new drugs with higher premiums for patients and €2.2 billion in temporary rebates and price freezes on older medicines.

For drugmakers, there are roughly six steps in the process. After about six months of internal assessments, companies set the price for new drugs, as AstraZeneca did when it started selling Brilique, known as Brilinta in the U.S., in January. That price becomes the starting point for negotiations with regulators.

22%

Premium for AstraZeneca's Brilique blood thinner vs. Plavix

Companies must file a dossier with the Federal Joint Committee, the German body that makes drug reimbursement decisions, to prove the new medicine is better than comparable therapies already on the market. If it fails that test, the drug gets priced like existing ones—which can mean a very big discount. For example, Brilique currently sells for about 22 percent more than Plavix, an older blood thinner. If a new medicine can clear that qualitative hurdle, price talks start between the drugmaker and the public insurers that cover some 90 percent of Germany's population to negotiate a rebate to insurers on the original price.

Just how much the new process will save in the long run is unclear. Rösler's plan was for savings from price negotiations to equal the €2.2 billion in temporary rebates by 2013, says Rainer Hess, head of the Federal Joint Committee. Proponents of the law say it's meant to keep a lid on spending and ensure that only the real innovators get rewarded. "If it's a groundbreaking new product, we're ready to pay," says Ann Marini, a spokeswoman for the National Association of Statutory Health Insurance Funds.

AstraZeneca could use some good news on Brilique. The company has already withdrawn its application for the drug in France—which represents one-third of the European market for anti-clotting drugs, according to Sanford C. Bernstein—after authorities asked for more information about side effects. The company says it intends to refile. In the U.S., the Food and Drug Administration initially rejected the drug in December. A second review is slated for July.

Lilly's Lechleiter says the emphasis on having to prove a new drug is better is prompting some drugmakers to start thinking like regulators. For instance, aside from running a medical study designed to show Brilique works better than Plavix, AstraZeneca also commissioned an economic review of the data using a ratio known as quality-adjusted life year (QALY). The measure tries to estimate both the number of years of life that would be added by a medical intervention and the quality of that existence based on the patient's level of health—on a scale of 1.0 for perfect health to 0.0 for death—during the extension. The QALY measure is traditionally used by government agencies such as Britain's National Institute for Health and Clinical Excellence, which advises the National Health Service on treatment cost-effectiveness.

AstraZeneca's internal review found that Brilique provided a quality-adjusted life-year gain of 0.13 on a scale of 0 to 1, with 1 being the best health benefit. The additional cost per year of putting someone on Brilique instead of the existing standard would be €2,500 to €5,700, the company reported. Explains AstraZeneca spokeswoman Abigail Baron: "Increasingly, we're looking for ways to demonstrate the value of our medicines."

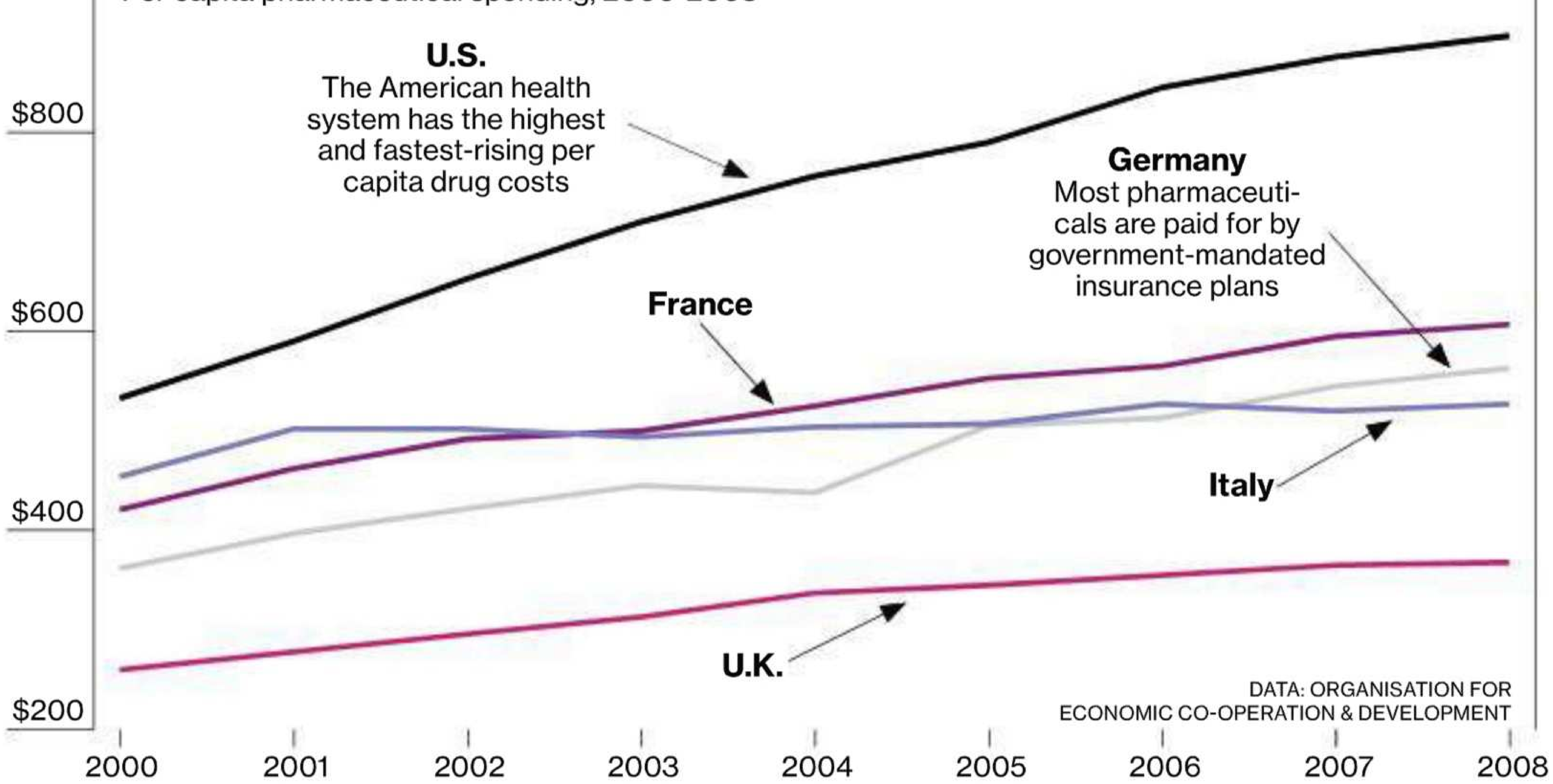
Justin Smith, an analyst with MF Global UK in London, says AstraZeneca's analysis released in May was the first time he had seen a company touting the QALY benefit of one of its compounds. If the German model takes hold elsewhere, it likely won't be the last.

—*Naomi Kresge and Allison Connolly*

The bottom line *New German rules on pharmaceutical prices are pushing drug companies to think more like regulators.*

DRUG BILLS KEEP RISING

Per capita pharmaceutical spending, 2000-2008



DATA: ORGANISATION FOR ECONOMIC CO-OPERATION & DEVELOPMENT

Autos

Aston Martin's $50,000 Compact for the Masses

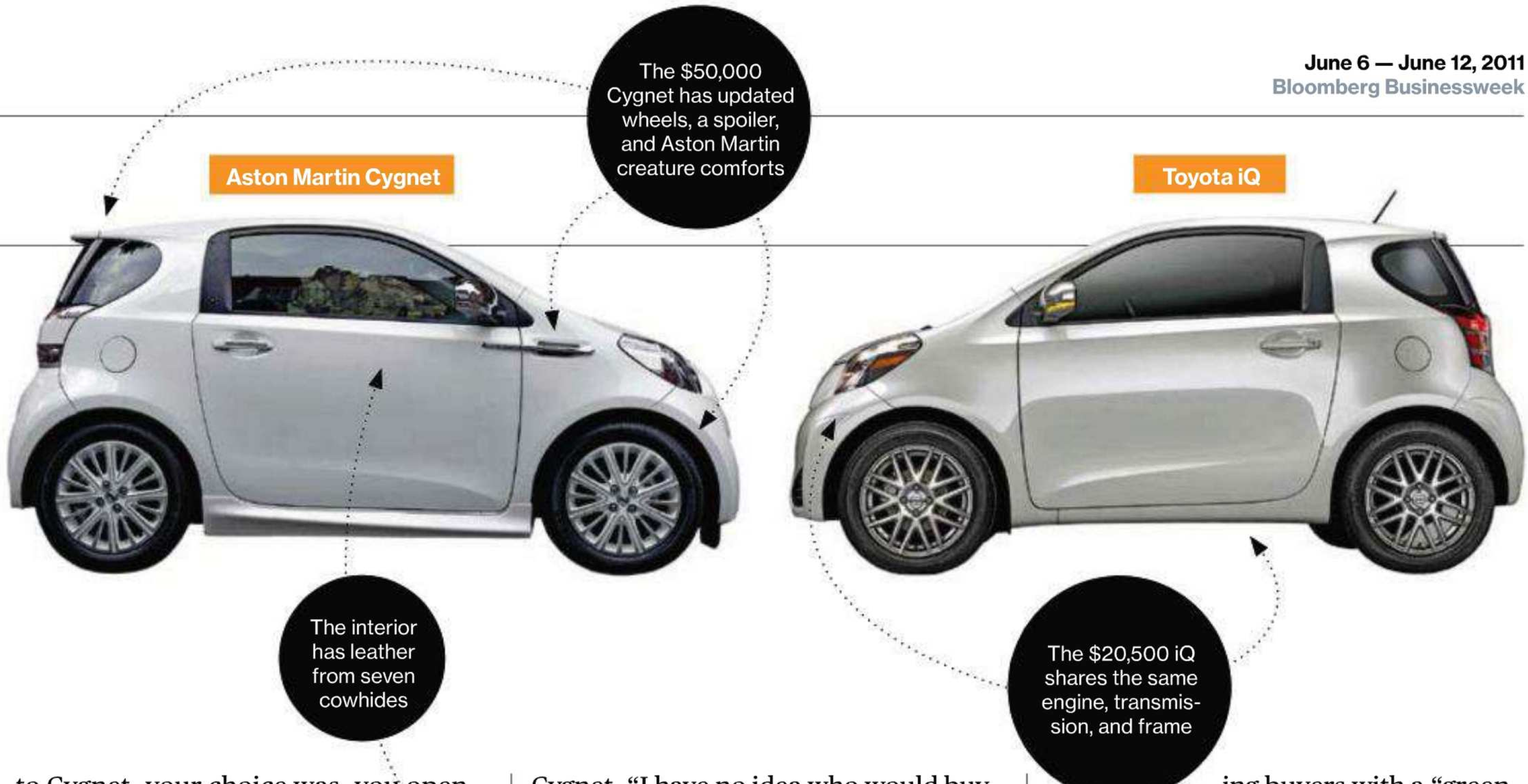
▶ The new Cygnet is based on a $20,500 Toyota model

▶ "Open the door, and you'll be hit by this wonderful smell of leather"

Aston Martin, the maker of sports cars favored by Prince Charles, not to mention James Bond, isn't a brand you'd expect to court drivers looking to squeeze into tight parking spaces. Yet in an effort to broaden its appeal, the English automaker is betting that the Aston Marton logo on the grill and plenty of hand-stitched leather gracing the interior will persuade buyers to pay £30,995 ($50,500) for its Cygnet urban subcompact that debuts this month. That's more than double the price of **Toyota Motor**'s iQ, which shares the same engine, transmission, and frame with the Cygnet. Still, the price is a pittance compared with the $285,000 DBS, 007's latest Aston.

"This car is a luxury city car," says chief designer Marek Reichman. "Prior

BRIAN SNYDER/REUTERS; OPPOSITE PAGE, CYGNET: MATTHEW LLOYD/BLOOMBERG (2)



to Cygnet, your choice was, you open the door and it smells of plastic; now you open the door, and you'll be hit by this wonderful smell of leather."

Aston Martin relied on a component supply deal with Toyota to cut the cost and production time for the Cygnet. The ultra-luxury carmaker, which **Ford Motor** sold to private investors in 2007, developed the model in about 12 months, far less than the three years typical for most car projects. Aston Martin needed the quick turnaround to boost demand as its owners seek new funding. **Investment Dar**, the Kuwaiti financial services company that owns half of Aston Martin, has challenges of its own. In May 2009, Investment Dar missed a scheduled $100 million payment on an Islamic bond and in March reached a plan with its creditors to repay that debt.



Aston Martin, which doesn't disclose financial results, aims to sell 1,500 Cygnets a year, which would make it the company's second-best seller after the V8 Vantage, which sells about 2,000 vehicles a year. Overall, Aston Martin's sales in 2010 gained about 6 percent, to 4,250 cars, according to the company.

Environmental pressure and growing city populations have prompted luxury carmakers to tailor cars for urban drivers. **Volkswagen**'s Audi rolled out the A1 subcompact last year. **BMW**, the luxury leader, will introduce an electric-powered city car in 2013. **Daimler**'s Mercedes-Benz later this year will start selling a revamped B-Class compact, the first in a line of four new small cars.

Not everyone is thrilled with the Cygnet. "I have no idea who would buy an Aston iQ or why they would even want one—it looks just daft," says Simon Empson, managing director of U.K. discount car website broadspeed.com. "Extending the brand is all well and good—fitted luggage and sunglasses I get—but city cars I just don't," says Empson, who previously owned the Aston Martin DB5 featured in the film *The Italian Job*.

Cygnet buyers will get a leather interior made from seven cowhides, the same number used in the $205,387 DB9 sports car, Reichman says. Aston Martin will offer six types of alloy wheels and as many as 3 million possible combinations of trim and color options. A navigation system, six-speaker stereo, and leather-clad steering wheel and gear shift are standard.

Beneath the hood, however, the Cygnet's 97-horsepower engine is essentially unchanged from the one in the $20,500 Toyota iQ. The Cygnet accelerates to 100 kilometers (62 miles) per hour in about 11.6 seconds, the slowest of any Aston Martin. That's an eternity next to the 3.7 seconds for the carmaker's 750-horsepower One-77 sports coupe. "It's not about naught to 60 speeds, or road holding or handling, or great racing capabilities," explains Reichman. "In the city, space is far more at a premium. You've got fewer chances to park, far more congestion, so it makes sense that our customers have a small luxurious product."

The Cygnet also gives Aston Martin a more eco-friendly product, providing buyers with a "green halo," says Peter Schmidt, editor of *Automotive Industry Data*. The compact emits about 120 grams of carbon dioxide per kilometer, compared with 572 grams for the One-77. "The attitude of the super-rich has changed," Schmidt says. "They really do want to be seen to be green. People can turn up at their golf club in this car, and it will be a talking point, and Aston Martin owners love talking about their cars." —*Steve Rothwell*

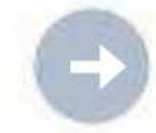
The bottom line *Aston Martin is betting there's a market for luxe urban compacts. It already has orders for 400 of its $50,000 Cygnets, debuting this month.*

Entertainment

For Woody and Buzz, Forget Retirement

- **Film shorts featuring *Toy Story 3* characters may spur product sales**
- **Hyping stars "without ... fans waiting two or three years for a new movie"**

When **Walt Disney** releases *Cars 2* on June 24, the audience will get a six-minute bonus. Buzz Lightyear, Woody, and other stars of *Toy Story 3*, another film made by Disney's Pixar animation studio, will romp and joke about Ken and Barbie's failed attempts to hitch a ride to Hawaii inside their owner Andy's book bag. It's more than a warm-up act: The short is intended to help keep sales humming for merchandise based on the *Toy Story* franchise, which already rivals Disney's Mickey, Minnie, and Winnie the Pooh lines in sales.



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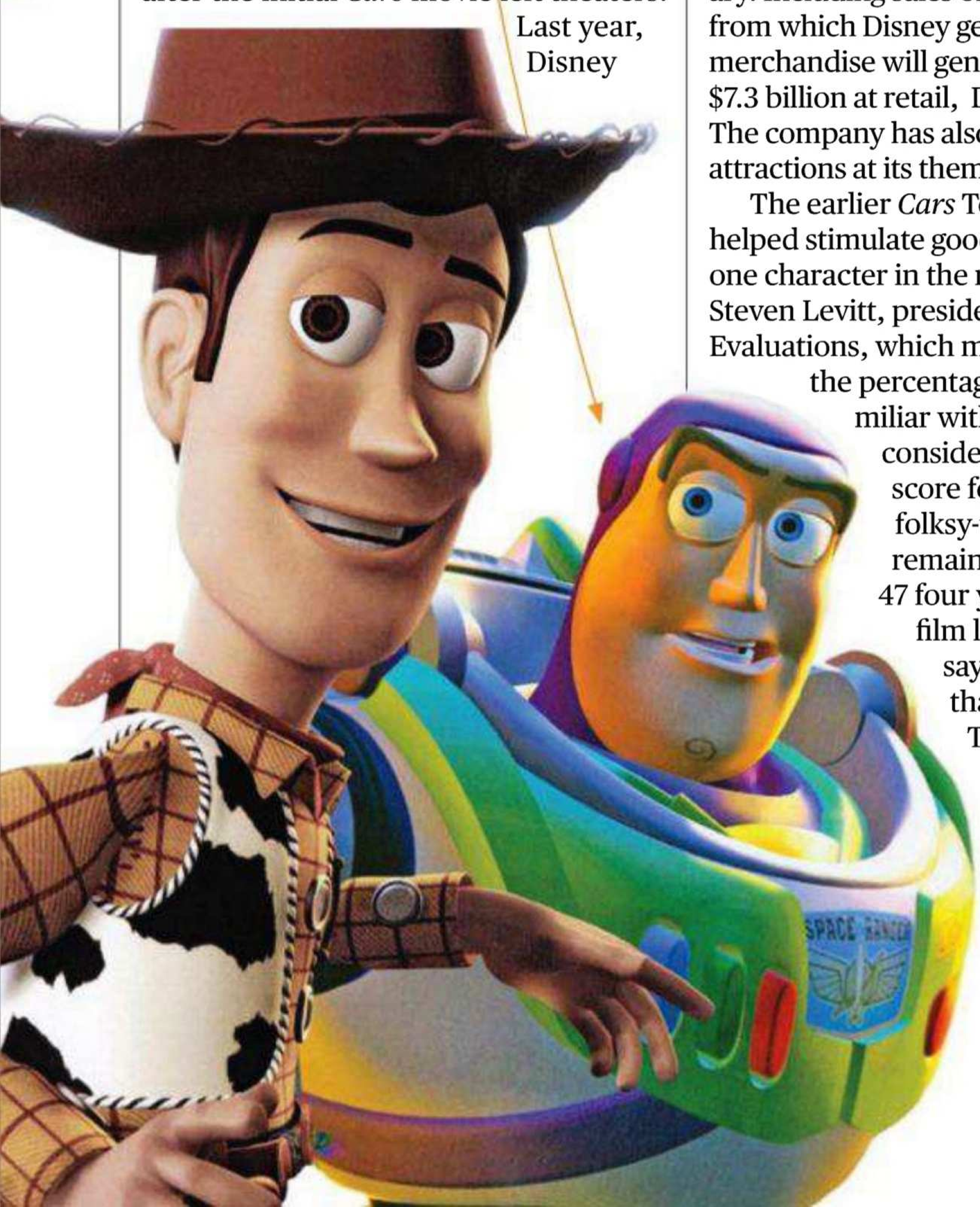
$7.3bn

Total expected retail sales of *Toy Story 3* merchandise

While movie studios have long run animated shorts before the main attraction in theaters, *Toy Story: Hawaiian Vacation* marks a bold effort by Disney to capitalize on Americans' habit of accumulating toys, lunchboxes, and other consumer goods tied to movies. "Showing those shorts is a super-smart strategy for Disney," says Albie Hecht, former president of Nickelodeon Film & Television Entertainment and founder of Worldwide Biggies, a digital studio that produces films and TV shows for young adults. "It's a way to extend the characters and the brand without its fans waiting two or three years for a new movie."

The *Toy Story* "Toon," as Disney calls it, was created in the 20,000-square-foot DisneyToon Studios that Pixar opened in Vancouver, B.C., in 2010 to make short flicks based on its movies. Disney started making *Cars* Toons in 2007, running them online, on its cable channels, and occasionally before a feature. That's one reason, says Evercore Partners analyst Alan Gould, that Disney's revenue from *Cars* merchandise rose 11 percent, to $240 million, in fiscal 2010—four years after the initial *Cars* movie left theaters.

Last year, Disney also packaged the shorts and sold them as a DVD. But the *Toy Story* franchise is much larger and more financially important to the company.



Jim Morris, Pixar's general manager, says the shorts allow Pixar to "create great entertainment experiences" while prolonging the brand's relevance. "Our plan is to keep the *Toy Story* experience top-of-mind to our consumers between films and to help the franchise," he says.

The *Toy Story* short cost $6 million to produce, according to a person with knowledge of the budget. It puts Buzz and Woody back in front of families a year after *Toy Story 3*'s premiere, just as memories might be fading, says Gould. That film grossed $1.06 billion in worldwide ticket sales, according to researcher Box Office Mojo. That makes it Disney's biggest animated film ever and its second-largest overall after *Pirates of the Caribbean: Dead Man's Chest*.

Disney's estimates peg *Toy Story* as the fourth-largest merchandise franchise of 2010, after its Mickey Mouse, Pooh, and Princess doll collection and ahead of **Mattel**'s Barbie line, Chief Financial Officer Jay Rasulo told analysts in February. Including sales of licensed products from which Disney gets a fee, *Toy Story 3* merchandise will generate more than $7.3 billion at retail, Disney estimates. The company has also installed *Toy Story* attractions at its theme parks.

The earlier *Cars* Toons may have helped stimulate goodwill for at least one character in the new film, says Steven Levitt, president of Marketing Evaluations, which measures Q Scores—the percentage of people familiar with a product who consider it a favorite. The score for Mater, *Cars*' folksy-talking tow truck, remains a relatively high 47 four years after the first film left theaters, Levitt says—1 point higher than Mickey Mouse. That compares to Bugs Bunny and the M&M candy and *Toy Story 3* characters, which were the highest-ranked animated figures, with scores of 52, he says.

Pixar plans more *Toy Story* shorts to keep Buzz and Woody in the spotlight. A second Toon will play before *The Muppets*, which opens Thanksgiving weekend, the start of the holiday shopping season. The debut of *Toy Story: Hawaiian Vacation* also comes just weeks before Disney opens its $800 million Aulani resort on Oahu. Disney execs say there's no tie-in, but six minutes of Woody and the gang dreaming of frolicking in paradise can't hurt.
—*Ronald Grover*

The bottom line *Disney estimates* Toy Story *is the fourth-largest merchandise franchise of 2010. It's bigger than Mickey Mouse and Barbie.*

Environment

The Hazy Math Behind a Carmaker's Carbon Buy

▶ Chevy's plan to offset emissions may not be as green as advertised

▶ If offsets go to existing projects, "we're basically buying hot air"

Last year, Chevrolet announced an incentive for the environmentally minded. For anyone who buys a Chevy between Nov. 18 and the end of 2011, the company promises to purchase carbon offsets, which are payments meant to encourage environmentally friendly projects that reduce carbon emissions and mitigate the impact of the new autos' pollution.

Based on the first transaction in Chevrolet's $40 million plan, the actual carbon reductions will be far less than promised. The automaker is paying almost $750,000 to bolster a state program in Maine that insulates homes for low-income families. The investment is enough to weatherize 170 houses and reduce carbon emissions by 1,224 tons through 2014, according to the Maine State Housing Authority. Yet Chevrolet is receiving credits for 45,738 tons worth of reduced carbon—the total savings Maine expects through 2014 from weatherizing all 5,500 homes in the program.

The difference illustrates a peril in using carbon offsets to achieve environmental goals, according to Anja Kollmuss, a Zurich-based scientist associated with the Stockholm Environment

EVERETT COLLECTION (2); OPPOSITE PAGE, FROM TOP: HU WEIGUO/IMAGINECHINA/AP PHOTO; CLIVE MASON/FIFA/GETTY IMAGES

WorldMags

Institute and one of five co-authors of a handbook on carbon offset programs. Experts agree that carbon offsets are valuable only when they encourage emissions reductions that wouldn't have happened otherwise. "The key is that decisions are actually altered by the creation of this carbon credit," says Michael Wara, an assistant professor at Stanford Law School and a scholar of environmental law. "If they're not, then we're basically buying hot air."

In the Maine housing project, a $41.9 million grant from the U.S. government's economic stimulus plan is paying for 80 percent of the 5,500 homes to be weatherized. Other taxpayer-funded programs, including an insulation project from the Energy Dept., will pay for most of the rest, the housing authority says.

Although the government is footing most the bill, a new protocol from Verified Carbon Standard Assn. allowed Maine to sell credits equivalent to the entire project's savings. Verified Carbon is a Washington nonprofit that sets standards for carbon offsets. It was founded in 2005 by three groups including the International Emissions Trading Assn., which counts large emitters such as **Chevron** and **Duke Energy** among its 150 members. While many verifiers examine a project's motivation and audit the sources of funding to ensure that offset investments result in new emissions reductions, the carbon credit market needed a simpler approach to attract more participants, according to David Antonioli, chief executive officer of Verified Carbon Standard.

The new system means it's irrelevant that the emissions cuts almost certainly would have happened without the money from Chevrolet, according to Antonioli. "That misses the point," he says. The aim is to reward those projects that save far more energy than others, providing an incentive for housing developers and agencies to be more efficient, he says. Chevy paid above-market prices for the offsets, but because the per-ton cost of carbon is so low, it was able to purchase all of the program's carbon savings with an investment that will fund just 3 percent of the project.

In announcing its involvement, the **General Motors** division acknowledged that U.S. funds from an economic stimulus grant and other programs would contribute to the home improvements. Chevrolet said in a press release that its purchase of "associated carbon savings" was "providing additional money." Dale McCormick, director of MaineHousing, says carbon credit revenue will be critical to continuing the program as federal stimulus funds dry up. "We're very pleased with this project," says Bill Devine, cross-brand marketing manager at Chevrolet and the leader of its carbon reduction project. "We want to make sure that the offsets are beyond reproach."

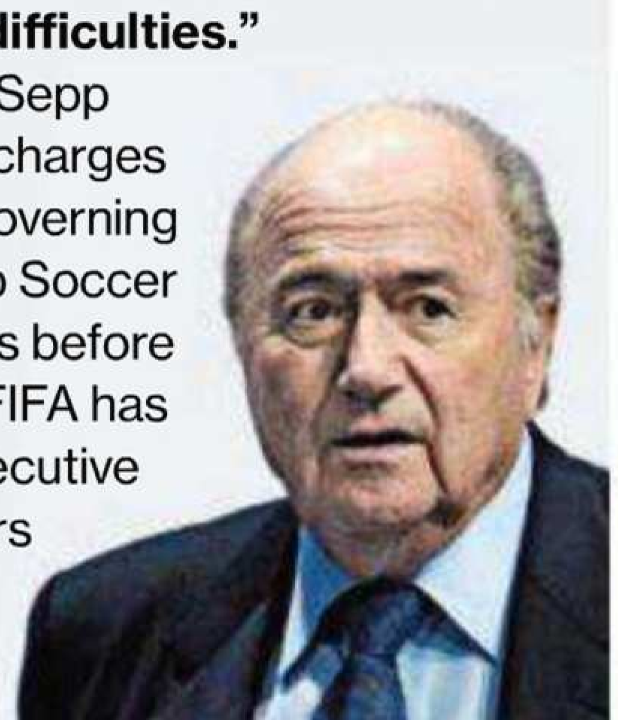
The U.S. allocated $5 billion of stimulus funds to weatherize homes through 2012. Wara, the Stanford professor, says that if other housing agencies were to follow Maine and sell carbon credits for the resulting emissions reductions, the market would be flooded with meaningless offsets. "It looks like a deceptive marketing claim," says Wara.

—Ben Elgin

The bottom line *Chevrolet will get credit for the carbon reduced by a Maine weatherization project even though the government financed most of it.*

Quoted

"Crisis? What is a crisis? We are not in a crisis, only some difficulties."
—FIFA President Sepp Blatter, dismissing charges of disarray at the governing body for World Cup Soccer on May 31, two days before he was reelected. FIFA has suspended two executive committee members in a bribery investigation.





A toy factory in Haozhou, in eastern China

Consumer Products

Even Santa's Worried About Chinese Inflation

▶ Higher wages and commodity prices are squeezing toymakers

▶ Shoppers will "face higher prices for Christmas gifts this year"

At the China Import & Export Fair in the southern city of Guangzhou in late April, one Western buyer protested against higher prices by wearing a T-shirt emblazoned with "Too Expensive" in Chinese. That generated little sympathy from toy seller Clara Zhang. "We all laughed so hard," says Zhang, 26, sales manager for China Nanjing Happy Toy, a maker of teddy bears and stuffed ducks. "Then we said, 'Sorry, sir, you probably need to pay even more.'"

Hundreds of toymakers at the fair, the country's largest trade show, are charging more as the world's second-largest economy fights inflation that soared to an almost three-year annualized high of 5.4 percent in March. There are about 8,000 toy companies in China, according to the government-affiliated China Toy Assn., and the country exported $2.6 billion worth of toys in the first four months of the year, 17 percent more than a year earlier.

"If you take into account everything Chinese toymakers are dealing with–labor, material, exchange rate–a price hike is only a natural consequence," says Hua Zhongwei, a macroeconomic analyst with HuaChuang Securities in Beijing. "There is a big chance for shoppers in the U.S. to face higher prices for Christmas gifts this year."

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Companies&Industries

Mattel, the El Segundo (Calif.) maker of Barbie dolls, announced a single-digit price increase for its products on Apr. 15. Hasbro, which makes toys including those for the Transformers and Spider-Man franchises, raised prices by 6 percent to 7 percent in February, according to David Hargreaves, chief operating officer of the Pawtucket (R.I.) company. "We haven't had pushback from the retailers," Hargreaves says. "They accept that the prices need to go up a bit." Toys "R" Us, the world's biggest toy retailer, anticipates "some price increases" for shoppers, says Kathleen Waugh, a spokeswoman for the company.

$308

Average monthly salary for workers in Chinese toy factories

Part of the pressure is coming from higher commodity costs, which are cutting into manufacturers' profit margins. The price of crude oil, the source for many of the chemicals used in toymaking, has risen more than 40 percent in the last year. Cotton prices surged 90 percent in the same period. China's appreciating currency has had a smaller, but significant, effect.

The biggest cause for the price hikes has been the rapid wage inflation in China's factory-heavy coastal region, where labor is in short supply. Worker salaries have almost doubled in the past year, to 2,000 yuan ($308) per month in factories in Guangdong province, the nation's manufacturing hub, according to toymakers attending the fair. "Wages are increasing day by day," says Jimmy Tang, general manager for Chenghai Junfa Toys in Shantou. "If you don't do it, people go somewhere else."

Li & Fung, the world's biggest supplier of toys to retailers including Wal-Mart Stores and Target, manufactures about half its products in China, and says it will pass on any factory cost increases to its customers. "Definitely, prices are going up on everything," says Bruce P. Rockowitz, chief executive officer of the Hong Kong-based company. "Every type of product." **B**

—Michael Wei with Marco Lui

The bottom line *Hasbro, Mattel, and other companies are raising prices in part because wages in Chinese factories have doubled and oil is up 40 percent.*

Briefs

by Karen Weise

Facebook/Google
Pushing back on do-not-track

Google and Facebook are joining forces to oppose a privacy bill in California that would limit online advertising. The measure would prohibit companies from collecting personal data, including names, phone numbers, and Internet browsing history, as well as from selling or sharing consumer data. Those data are the foundation of so-called observed behavior advertising that targets consumers based on their Web usage and location. Limits could trim ad revenue in the state by $579 million in 2014, according to a Bloomberg Government analysis. Although other state and federal lawmakers have proposed do-not-track bills, California's is the most far-reaching.



PBS
Adding commercial breaks



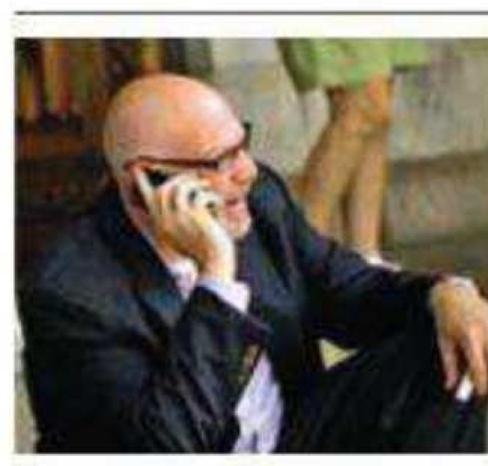
PBS is considering adding promotional breaks during programs, a departure from its decades-old practice of airing shows uninterrupted. It will test the new format on one night of programming each week to measure the response. Previously, PBS ran promotions for its corporate and foundation sponsors only at the beginning and end of each program, leaving viewers alone for up to 50 minutes. The new plan, which calls for four breaks per show, will drop ad-free stretches down to 15 minutes.

Fannie Mae/Freddie Mac
No-bid contracts from Treasury



Fannie Mae and Freddie Mac received more than $400 million in no-bid contracts with the Treasury Dept. to administer and enforce the Obama Administration's signature foreclosure relief program. The Congressional Oversight Panel said the government-run companies have a conflict of interest because they are both policing the program as well as using it to modify loans they own or guarantee. It also said the companies have ongoing business relationships with the mortgage firms they must police under the contracts.

Handset Makers
Warnings on using cell phones



Talking on cell phone handsets may increase risk of brain cancer, according to a survey of existing research commissioned by the World Health Organization. In its first definitive recommendation on the topic, the WHO labeled cell phones as "possibly carcinogenic," a category that includes diesel fuel and chloroform. The wireless industry challenged the findings, saying the survey did not involve new research and relied on potentially flawed data. An estimated 5 billion people use mobile phones worldwide.

Juan Valdez
Colombia promotes coffee in China

Juan Valdez
胡安·帝滋

Colombia's National Coffee Growers Federation is hoping to hook Chinese youth on coffee instead of tea. The Federation has created a new logo that uses the Chinese characters for "aroma" and "savor" alongside the trademark image of coffee farmer Juan Valdez. It is also hosting a coffee tasting for experts from China. Starbucks and Nestlé are planning to expand in China as well. Last year, China, Korea, Japan, and Australia absorbed 17 percent of Colombia's arabica coffee crop.

On the Move

Renault Nissan America's chief, Carlos Tavares, named COO

Time Warner Cable Irene M. Esteves appointed CFO

Federal Reserve Research Director David Stockton to retire after 30 years at the Fed

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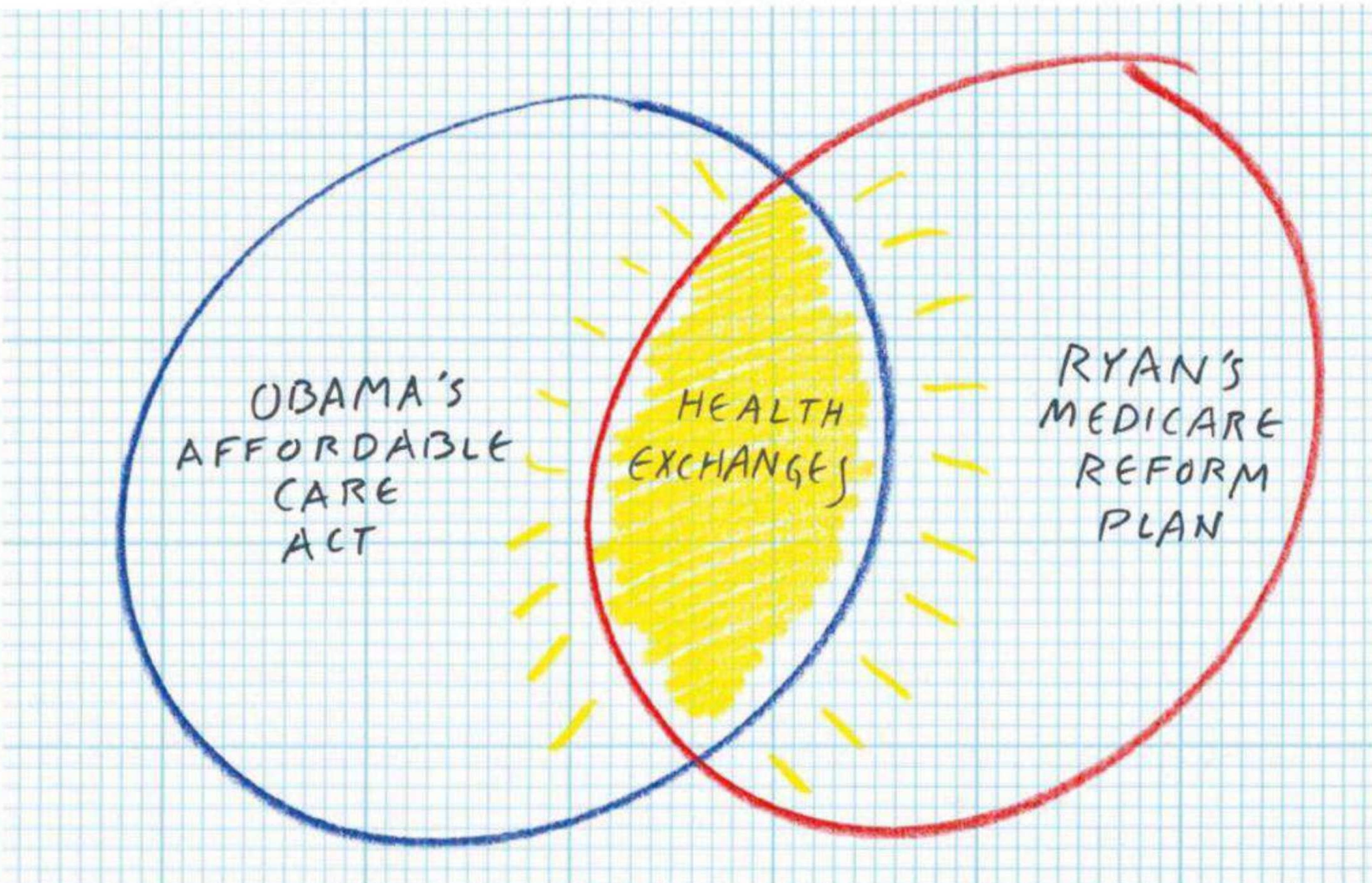


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132 Fairgrounds Road, West Kingston, RI 02892 USA • 998-2760_US *EcoStruxure architecture reduces energy consumption by up to 30%.

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▶ Charlie Rose talks to George Mitchell 38 ● Edited by Cristina Lindblad



The Happy Space In the Medicare Debate

▶ **Health exchanges may hold the key to bridging bipartisan divisions on reform**

▶ **"The real action is fundamentally reorganizing the delivery of care"**

Medicare is on track to consume 7 percent of gross domestic product by 2035, double the current level, according to a Congressional Budget Office scenario that incorporates widely expected developments. On May 13, Medicare's trustees predicted that the program's Hospital Insurance Trust Fund, which helps cover benefits for future retirees, would be exhausted by 2024, five years earlier than predicted last year.

Yet politicians are stalemated over competing fixes. "It's very sad," says Stuart M. Butler, director of the Center for Policy Innovation at the conservative Heritage Foundation. "Both sides know there's got to be a conversation."

Policy experts searching for something that might form the nucleus of a compromise are turning to the not-so-new concept of health exchanges. These are virtual marketplaces in which consumers shop for standardized health insurance policies. The government provides a subsidy to help many buy policies, with the amount greatest for the poor and the sick.

The Democrats' and Republicans' positions on health exchanges are almost mirror images

Health exchanges appeal to Republicans because they foster competition and offer choice, and to Democrats because in at least some versions they ensure a minimum level of coverage regardless of income. Exchanges are supposed to create incentives to keep people healthy at the least possible cost. "More cabbage, fewer CABGs," says Boston University professor and health blogger Austin Frakt, using the acronym for coronary artery bypass grafts. "The real action is fundamentally reorganizing the delivery of care,"



> "There hasn't been a serious bipartisan negotiation. That has to happen."
> —Alice Rivlin, Brookings Institution

and exchanges that make people better shoppers are a component of that, albeit not the only one, says Massachusetts Institute of Technology economist Jonathan Gruber, who has consulted for Democrats on health care.

Strangely, given the recent acrimony, the two parties' positions on health exchanges are almost mirror images. The deficit-reduction plan devised by House Budget Committee Chairman Paul Ryan (R-Wis.) contemplates health exchanges only for people 65 and older. President Barack Obama's Patient Protection and Affordable Care Act has them only for those who have not reached the age of Medicare eligibility. Alice M. Rivlin, White House budget director under President Bill Clinton, sees that divergence as an opportunity for compromise. "Chairman Ryan has had trouble explaining why he is for exchanges in his Medicare reform and against them in ACA, and President Obama has the opposite problem," Rivlin, a Brookings Institution senior fellow, wrote on May 16 on The American Square blog.

In a May 31 interview, Rivlin suggested the parties could meet in the middle on a plan that she and retired Senator Pete Domenici (R-N.M.) advanced last year as co-chairs of the Bipartisan Policy Center's Debt Reduction Task Force. A compromise would incorporate health exchanges into Medicare while keeping traditional fee-for-service care alive as one alternative. "There hasn't been a serious bipartisan negotiation," Rivlin says. "That has to happen."

Boston University economist Laurence J. Kotlikoff agrees with Rivlin that the Ryan plan for Medicare is strikingly similar to the Obama plan for working-age Americans. He says Democrats should embrace it for that reason, with two changes: Ryan's cost-cutting proposals should extend to current retirees, not only those turning 65 starting in 2022. And Kotlikoff says Ryan's ceiling on spending growth is unrealistically low. He would allow Medicare to grow at the same pace as the overall economy.

Not everyone is convinced that Republicans and Democrats can find common ground on health exchanges. Robert E. Moffit, a senior fellow at the Heritage Foundation's Center for Policy Innovation, says the two sides' aspirations for them are too different. Conservatives, he says, favor state-level exchanges with light regulation, while liberals want a single national exchange that, in his opinion, would be a stepping stone to single-payer health care. Says Moffit: "People on both sides of the ideological spectrum have written in favor of health exchanges, but I can promise you that they don't mean the same thing."

The only way to keep health-care costs from devouring the federal budget is to get all participants in the system working together. "We have amazing clinicians and technologies but little consistent sense that they come together to provide an actual system of care from start to finish," Dr. Atul Gawande, a surgeon at Brigham & Women's Hospital in Boston and writer for *The New Yorker*, told Harvard Medical School graduates in May. He encouraged them to function like members of a racetrack pit crew. The hope for health exchanges is that they can help bring about that kind of change. —*Peter Coy*

The bottom line *Both parties say they want health exchanges as part of health-care reform. They disagree on what exchanges are.*

Campaign 2012

Huntsman Woos The Romney-ians

- ▶ The onetime Utah governor is a pro-business, centrist candidate
- ▶ "I've had ... a CEO a day drop by" as governor and ambassador

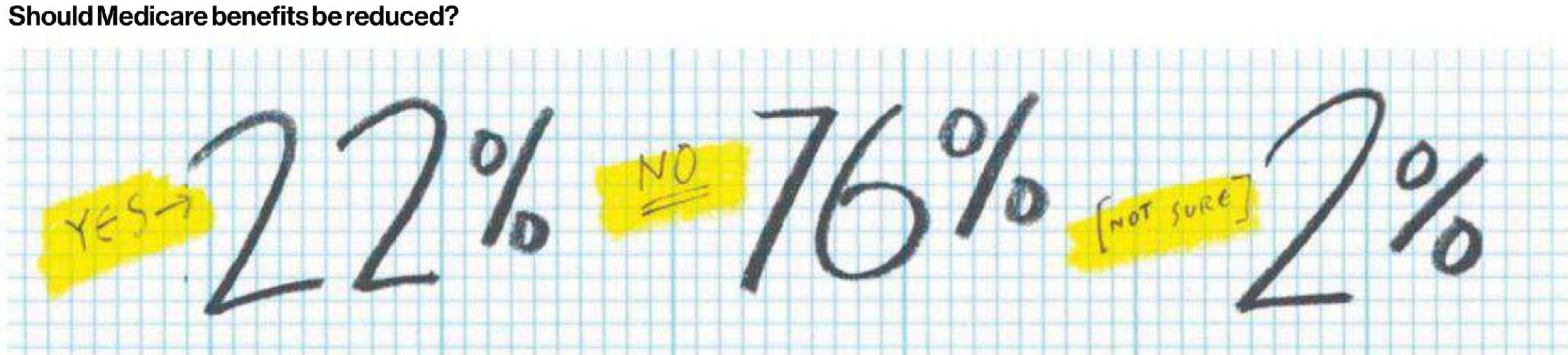
Standing outside a New Hampshire farmhouse in a faded jean jacket and brown corduroys, Republican Presidential hopeful Jon Huntsman Jr. issues a measured call for change. "This election cycle will put before all of us the prospect of a lost decade of growth," he says. "Or do we want to unleash the economic magic this country has shown the world time and time again?"

It's a campaign pitch better suited for a corporate boardroom than a Sunday barbecue in rural Franklin, N.H. That's O.K. with Huntsman, who says no candidate is connecting with business leaders the way he does. "I don't think there's any potential candidate in the field who's had as many conversations as I've had with CEOs," said the onetime Utah governor and former ambassador to China in an interview as he traveled to Concord. "I've had practically a CEO a day drop by in my life either as governor or as U.S. ambassador."

Huntsman, who has yet to formally declare his candidacy, waited until mid-May to make his first trip to meet with New Hampshire voters in their homes, diners, and VFW halls. His prospects in the state that hosts the first Presidential primary brightened with the May 22 decision by Indiana Governor Mitch Daniels not to run.

Like Daniels, Huntsman wears the

Should Medicare benefits be reduced?



BLOOMBERG NEWS NATIONAL POLL, MAR. 4-7

BRENDAN HOFFMAN/BLOOMBERG; OPPOSITE PAGE: BRIAN SNYDER/REUTERS

WorldMags

Making Amazon a tax collector page 41 ▶





GOP Presidential hopeful Huntsman in Keene, N.H.

"adult in the room" label that GOP mandarins and business leaders say they are searching for. While former Governor Tim Pawlenty and Representative Michele Bachmann, both of Minnesota, cater to the Tea Party crowd, Huntsman is zeroing in on the GOP's traditional, pro-business wing. The trim, soft-spoken 51-year-old steers clear of divisive social issues such as abortion and gay marriage and doesn't tout his gun-toting credentials. Instead, he talks to voters about chipping away at corporate income taxes, scaling back government regulation, and boosting trade.

As another candidate, Representative Ron Paul (R-Tex.), inveighs against the Federal Reserve, Huntsman credits the central bank with playing a key role in the recovery. And while the rest of the GOP field talks of China as a threat, Huntsman, who is fluent in Mandarin, stresses its market potential. "We will have more and more export opportunities for our small and medium-size businesses," he says. "So you want to change attitudes about China." That's a hard sell with voters such as Marty Russo, a retired serviceman who heard Huntsman speak in Franklin. "It's nice that we do business with China," he says. "But they still want to grind us into the dirt."

To reinforce his business credentials, Huntsman points to his record in Utah, where he moved the state from a progressive income tax with a top rate of 7 percent to a flat 5 percent tax. In meetings with CEOs, he also highlights his experience as an executive with **Huntsman Corp.**, his family's plastics and chemical company. John Frisbie, president of the U.S.-China Business Council, says Huntsman often met with top U.S. executives during his tenure in Beijing. "He's clearly very well regarded with the business community both on the ground in China but also back here, too," says Frisbie.

Huntsman is not the only Republican with business chops. There's former Massachusetts Governor Mitt Romney, another ex-business executive. "[Huntsman] is clearly to my taste, but so is Mitt Romney," says Michael L. Ashner, chief executive officer of **Winthrop Realty Trust**, a publicly traded real estate investment trust headquartered in Boston. Ashner, who raised more than $1 million for Senator John McCain (R-Ariz.) in the 2008 Presidential election, met with Huntsman recently. "Those are the two I'm focused on."

As he woos corporate cash, Huntsman can't ignore the Tea Party wing, a valuable source of manpower for any GOP campaign. As Republican skepticism of climate change has grown, he backed away from his support for a cap-and-trade system. The economy, he says, is too fragile to demand that businesses reduce their carbon emissions. Huntsman stands by his support for comprehensive immigration reform, though he notes he isn't sure there is the "appetite or the mood" to fix the problem unless the border is secured first. And he wouldn't say whether he would have voted for government rescues of the financial sector and auto industry, reviled by Tea Party activists as bailouts. "I know experts at the time argued that there wasn't much choice in the matter unless you wanted the

country to go into a depression," he says. Still, he's quick to add, "I'm not saying what I would have supported."

William Mack, founder and chairman of **Area Property Partners**, a real estate fund manager, says Huntsman is "middle-of-the-road in a lot of situations," something he appreciates. The big question is whether that kind of steady, pro-business centrism is enough to win over his party. —*Lisa Lerer*

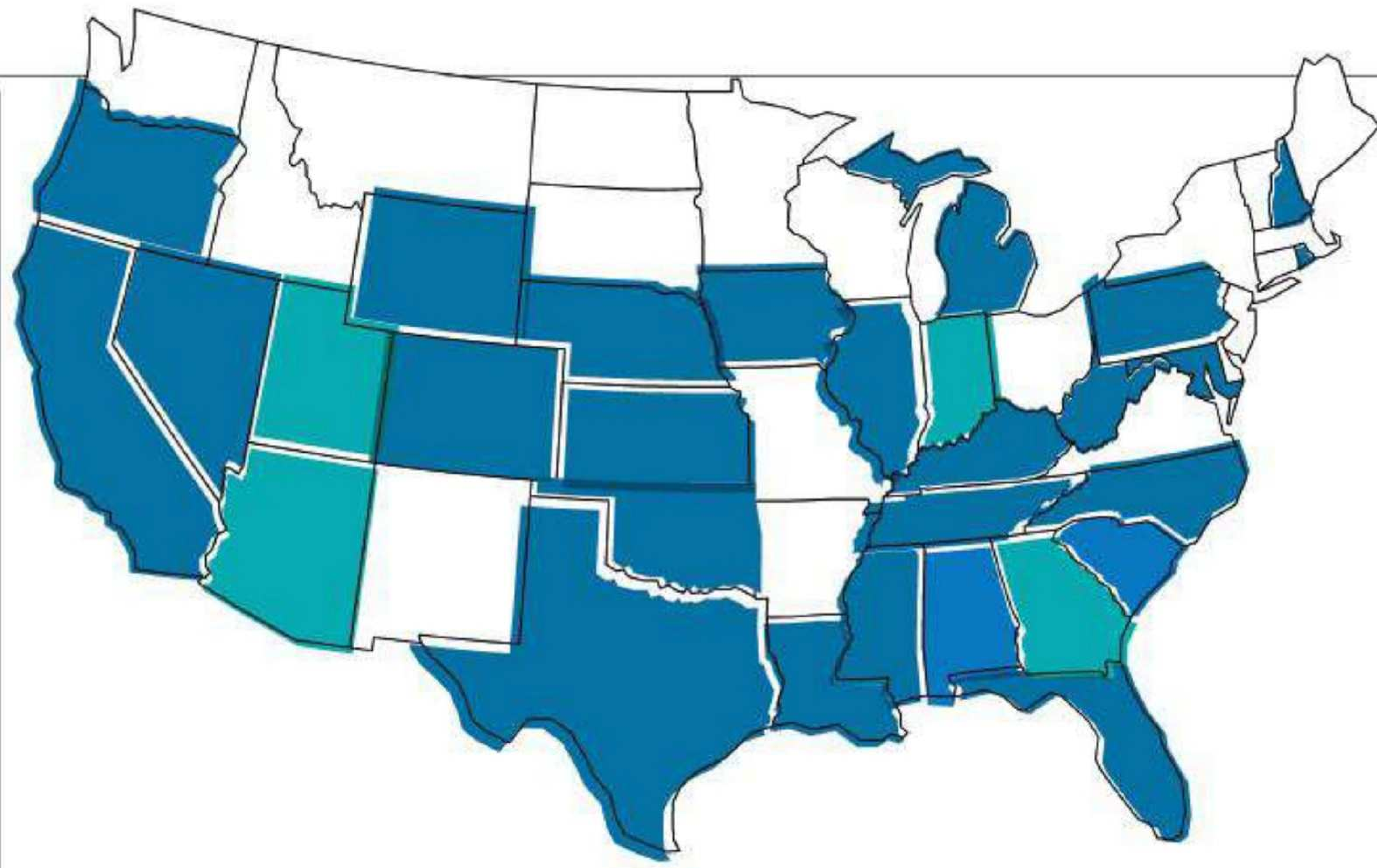
The bottom line *Huntsman is competing with Romney to be the GOP's Establishment candidate. It remains to be seen if his time in China will be an asset.*

Immigration

A Push for Arizona-Style Laws Stalls Out

▶ Tougher enforcement faces resistance from business

▶ "We did not want to see damage done to Florida's brand"



States that have passed or considered immigration bills in 2011 and the share of their labor force that is undocumented

Enacted

Arizona*	7.4
Georgia	7.0
Indiana	2.3
Utah	5.4

*Arizona enacted its legislation in 2010

Failed or Postponed

California	9.7
Colorado	4.6
Florida	6.6
Illinois	5.6
Iowa	3.2
Kansas	3.3
Kentucky	2.6
Louisianna	2.0
Maryland	6.2
Michigan	2.0
Mississippi	2.9
Nebraska	3.0
Nevada	10.0
New Hampshire	1.6
North Carolina	5.4
Oklahoma	3.0
Oregon	5.3
Pennsylvania	1.7
Rhode Island	3.7
Tennessee	3.1
Texas	9.0
West Virgina	0.5
Wyoming	1.5

Under Consideration

Alabama	4.2
South Carolina	2.1

DATA: PEW RESEARCH CENTER

In his successful campaign to become Florida's governor last year, Rick Scott argued that his state needed an immigration law similar to the controversial statute passed in Arizona, which gives police broad powers to question people about their legal status. He skewered his opponent in the primary for calling the law too "far out." Governor Scott has since learned that a lot of his fellow Republicans agree with that assessment. The state's Republican-dominated legislature adjourned for the year on May 7 without agreeing on an immigration bill, much to the relief of business groups, including the Florida Chamber of Commerce, that came out strongly against the measure.

"We did not want to see damage done to Florida's brand," says David Hart, executive vice-president of the Florida Chamber, citing the potential blow to the state's tourism industry if Florida came to be viewed as "inhospitable" to foreign visitors.

Resistance from business, along with legal challenges, have limited the spread of state immigration laws patterned after Arizona's. Bills expanding enforcement of immigration laws were introduced in 28 states this year, but passed in just three, Georgia, Utah, and Indiana–and in the Hoosier state only after legislators softened some provisions. In Florida and 22 other states, legislation failed or stalled in committee. Legislators in Alabama and South Carolina are working to reconcile differences between House and Senate versions of the bills.



In Florida, business groups particularly objected to a provision that would require employers to screen prospective workers using a federal immigration database. "I truly don't think you could pick the crops in the fields" if employees' names had to be run through the federal verification system, J.D. Alexander, a Republican, told fellow state senators on May 3. Alexander is an investor in Florida citrus farms.

The potential cost of such legislation has been a constant refrain of opponents nationwide. A 2008 report commissioned by Americans for Immigration Reform argued that removing all unauthorized workers from the labor force would cut $245 billion in economic output. After Arizona's law passed last year, the Los Angeles City Council banned local agencies from doing business with companies from the state. Also, several organizations, including the Service Employees International Union, said they would not hold conventions in the state. The boycotts could cost Arizona $253 million in economic activity over two to three years, estimates the Center for American Progress. "States are saying, 'Yes, let's debate it' and then deferring until next year" while they study the potential economic and legal effects, says Ann Morse, director of the Immigrant Policy Project for the National Conference of State Legislatures.

FROM TOP: JOSHUA LOTT/BLOOMBERG; JANEK SKARZYNSKI/AFP/GETTY IMAGES

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While proponents of tougher legislation took heart from a May 26 U.S. Supreme Court ruling upholding a 2007 Arizona law that lets the state close businesses that hire undocumented migrants, legal experts say it's unclear whether that will give momentum to stalled immigration bills elsewhere. "It's a very subtle shift to the extent that we're all trying to read the tea leaves," says Ilya Shapiro, a senior fellow at the Cato Institute. "You can't draw too many conclusions." Last year the U.S. Justice Dept. successfully sued in an Arizona federal court to block provisions of the state's 2010 law that require police to determine the status of people stopped for questioning, arguing that these interfere with the federal government's authority to set immigration policy. That case is likely to reach the Supreme Court.

"We can't have 50 different immigration laws around the country," President Barack Obama said in an Apr. 27 interview with Atlanta TV station WSB, a few weeks after the Georgia's legislature approved one of the nation's toughest immigration laws. Southerners on New Ground, an Atlanta nonprofit that champions minority rights, is asking businesses to cancel conventions in the state. The group has also threatened to organize consumer boycotts against companies headquartered in Georgia, including **Coca-Cola**, **Delta Air Lines**, and **Home Depot**. "Calling for boycotts is not productive," Charlie Sutlive, a spokesman for Coca-Cola, said in an e-mail. "Consumer boycotts hurt the local economy, local businesses, and local employees."

Scott wants Florida's bill to be taken up again during the next legislative session. "If the federal government doesn't do their job," said the governor at a May 19 news conference, "the legislature should do theirs."

In Florida many undocumented migrants are leaving anyway. The state's unauthorized population fell 21 percent to 760,000 in 2010 from three years earlier, according to the U.S. Homeland Security Dept. Nationwide, the number of illegal residents fell by almost 1 million, or 8.7 percent, from 2007 to 2010, as the recession limited job opportunities. —*Simone Baribeau, with Christopher Palmeri and Greg Stohr*

The bottom line *While 28 states this year have considered legislation toughening immigration enforcement, only three have passed laws.*

Defense

The High Cost of Waging War on Rust

Amount the Pentagon spends each year to fight rust across the defense fleet

$22.9bn

- **Corrosion eats up Pentagon savings as aging B-52s keep flying**
- **"It's not very sexy work. It's just hard work"**

On June 6-9, Norfolk, Va., will play host to Mega Rust 2011. That's not a gathering of middle-aged Metallica fans but a conference sponsored by the U.S. Navy to bring together experts in the field of corrosion and discuss the latest prevention strategies.

The Pentagon spends $22.9 billion a year fighting rust—almost twice as much as the cost of a new Navy aircraft carrier and about as much as 55 F-22 Raptors, the Air Force's premier fighter jet. Dealing with corrosion in ships, tanks, planes, and other equipment will cost an estimated $114.5 billion over the next five years. The sum dwarfs the $78 billion in savings projected in outgoing Defense Secretary Robert M. Gates's budget, which covers the same period. "It's certainly a huge expense, and I fully expect it will grow," says Winslow T. Wheeler, director of the Straus Military Reform Project at the Center for Defense Information in Washington. "The equipment inventory of all services is significantly older than it used to be."

To battle the stealth enemy, Congress in 2003 mandated the creation of a Corrosion Policy and Oversight Office within the Pentagon. "Corrosion is a pervasive menace," says Daniel Dunmire, the office's director, who heads a four-person crew that works out of leased office space about a mile from the Pentagon. "We can't afford not to do something about it." Dunmire is optimistic that new technology and stepped-up maintenance could cut the annual cost of corrosion by as much as 30 percent in about 20 years.

News from the front lines is encouraging. At the Navy, where fighting the effects of saltwater is a never-ending chore, a new method for coating the tanks used to carry jet fuel and ballast water on ships could save about $240 million in maintenance over the next 10 to 20 years, says William Needham, a retired Navy captain who now works for the service as a corrosion engineer. What used to require three coatings can now be done with just one, he says. Rust on Navy ships and Navy and Marine Corps aircraft that travel on them makes up $6.2 billion of the Pentagon's annual corrosion bill, according to data compiled for the Defense Dept. by LMI, a consulting firm in McLean, Va.

Ted Bates, a technical fellow at **Boeing**, says corrosion has become more of a problem because of the military's decision to extend the life of aging aircraft. The B-52H bomber was designed by Boeing in the 1950s and built in the early 1960s to operate for 12 to 15 years. Fifty years later the B-52s are still in service. Battling rust on the planes, says Bates, may require replacing metal, applying coatings, or designing and making new parts. "It's not very sexy work," says Bates. "It's just hard work."

Lockheed Martin, builder of the F-22 Raptor fighter jet and the new F-35 Joint Strike Fighter, has spent more than $15 million in research and development on corrosion prevention strategies in the past 10 years, according to company spokesman Joe Stout—a figure that includes government subsidies. Corrosion became a problem in the F-22 soon after the plane was introduced in 2005. The tab for repairs is expected to run to $228 million through 2016, according to the Government Accountability Office.

The Marine Corps, the military's smallest service, is the only one to have seen corrosion costs drop in recent years, from $545 million in 2005 to $460 million in 2008. Matt Koch, the Marines' program manager for corrosion prevention and control, says the savings are the result of a 2005 decision to outsource the maintenance of vehicles. "There are more things the Marines should be doing other than busting rust," says Koch.

As part of its efforts to hold rust at bay, the Defense Dept. is helping fund the country's first bachelor's degree program in corrosion engineering at the University of Akron. Enrollment in the program, which is about a year old, will grow gradually. Ten students have completed their freshman year, and there is room for as many as 30 in classes that begin this fall. —*David Lerman*

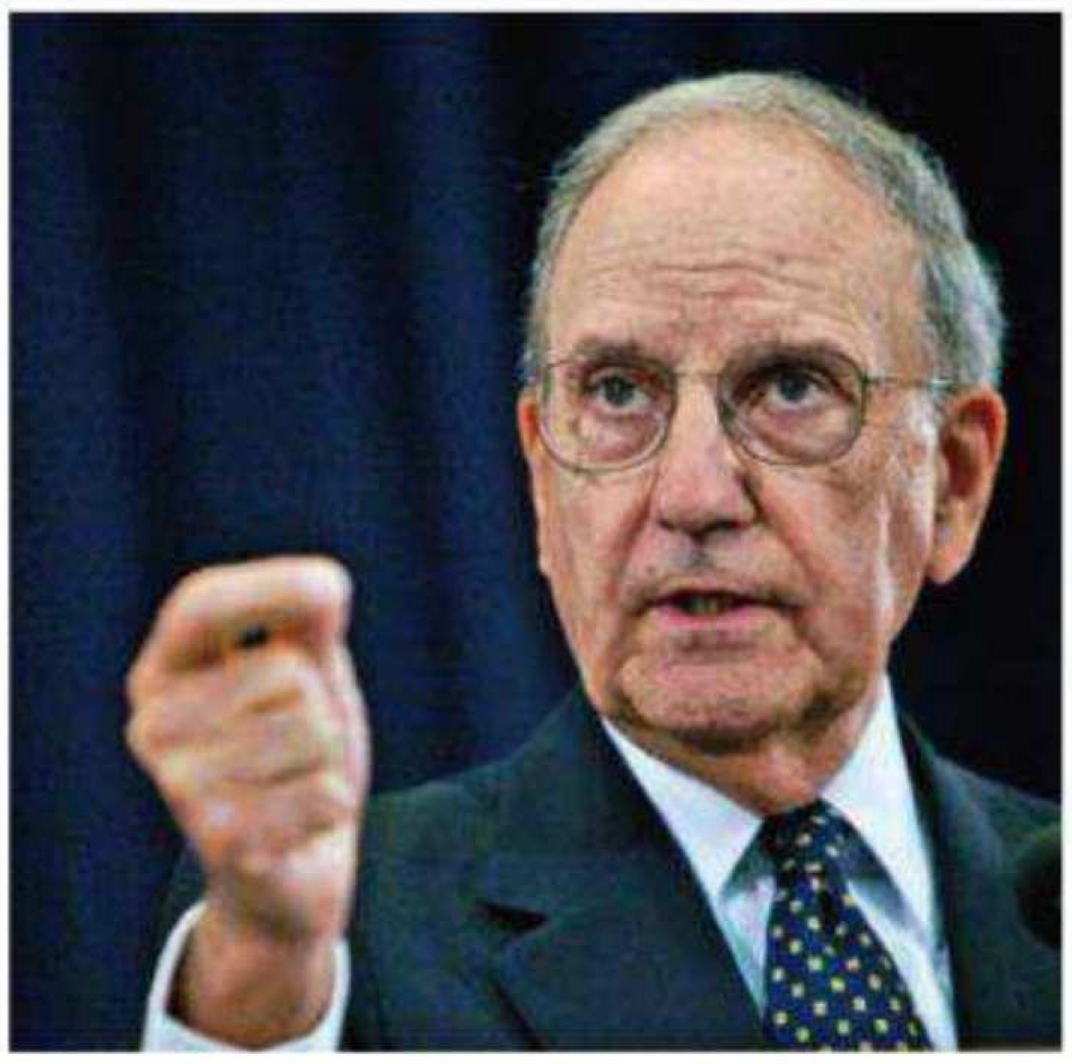
The bottom line *Outsourcing and new technologies are key to the Pentagon's plans to cut the cost of fighting rust by 30 percent in 20 years.*

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Charlie Rose talks to George Mitchell

“Walls provide temporary relief, but they don’t solve the ... problem. In this case, it’s rocketry”



Obama’s newly retired special envoy to the Middle East explains the President’s push for Israeli-Palestinian progress and the region’s biggest risks

Where do you stand on recognition from the United Nations of a Palestinian state?
Understand, the UN does not have the authority to recognize states. States are recognized by other states. But a UN resolution—especially if passed by an overwhelming margin—would have profound effects. And those states that voted for it would then move toward recognition on their own. That would, I think, be a harmful development—very harmful for Israel, for the U.S., and for the peace process. The way for the parties to get an agreement, the way for the Palestinians to get a state, the way for Israelis to feel secure, is through a negotiated agreement with active American assistance.

What gets everyone back to the table?
Well, both sides have to accept the President’s statement as the basis for negotiations. That will be very difficult for both.

And there’s not much time, with regard to the UN resolution.
A matter of a few months. As the President said, the Palestinians walked away from the talks because their demands were not met. Their demand for an extension of the moratorium on new housing in the settlements that had been in place for 10 months was not extended, so they left the talks. ... What the Palestinians have to do is come back.

What do you make of Prime Minister Netanyahu’s argument about the Hamas-Fatah agreement?
That’s a very serious matter. I think the Prime Minister is correct that it’s very difficult for Israel to negotiate with a party that is committed to Israel’s destruction. However, what President Abbas has for many years stood for—nonviolence and negotiation—makes him the person Israel and the U.S. should be empowering. We don’t know how this Hamas-Fatah thing will develop. [Abbas] says that he is going to organize it in a way that the purpose of it is to hold an election. So we say we’re for democracy, Israel says they’re for democracy, and we should not be discouraging an election. Obviously we hope that Abbas and Fatah will win.

What impact has the Arab Spring had on Israeli-Palestinian relations?
Very significant. It has created a great deal of uncertainty for the Israelis, for the Palestinians, indeed for everyone else, including us. Make no mistake, what is happening in the Middle East now is a major turning point in the history of that region. And given its political importance, particularly with respect to petroleum, it’s therefore a major turning point in the world. We don’t know how it will work out. This will take some time to unfold. It will not be quick, it will not be easy, and it will not be even. One of the things that President Obama, I believe, was squarely correct on was the focus on Egypt. Egypt is the largest country that has the longest national history.

And the largest army.
Arguably the greatest influence. What happens there will be very important.

Netanyahu says the crucial matter is security. How can the Israeli public be satisfied on that issue?
Here’s the argument I’ve made to the Prime Minister in the past. Right now in that space between the Jordan River and the Mediterranean Sea, the number of Jews is slightly higher than the number of Arabs. But the trends are very clear. In a short time the Arabs will outnumber the Jews. So Israel would have to choose between a democratic state or what Defense Minister Barak has said, an apartheid state. I lived in Berlin, where there was a wall. I was in Northern Ireland, where there was a wall. And now the Middle East, where there is a wall. I can tell you walls provide temporary relief, but they don’t solve the underlying problem. And in this case, it’s rocketry.

You were one of Obama’s first appointments. It’s now two years later. Did you fail?
Well, I failed to get a peace agreement from the Israelis and Palestinians, but so has anyone else who’s ever tried. In that sense, yes, we’ve failed, and the consequence is a serious one. On the other hand, we did make significant progress.

You traveled more than you ever planned to.
When I talked to Arab leaders—and I’ve talked to all of them, the heads of every Arab state—almost all of them are deeply concerned about the threat from Iran. They’re also very concerned about the Israeli-Palestinian thing, but they recognize their best interests lie in a resolution of this conflict so that there can be a regional approach to dealing with the Iranian threat to them. Ⓑ



Watch Charlie Rose on Bloomberg TV weeknights at 8 p.m. and 10 p.m.

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IS REBUILDING AN ENTIRE COMMUNITY IN NEW ORLEANS
PROGRESS IS EVERYONE'S BUSINESS
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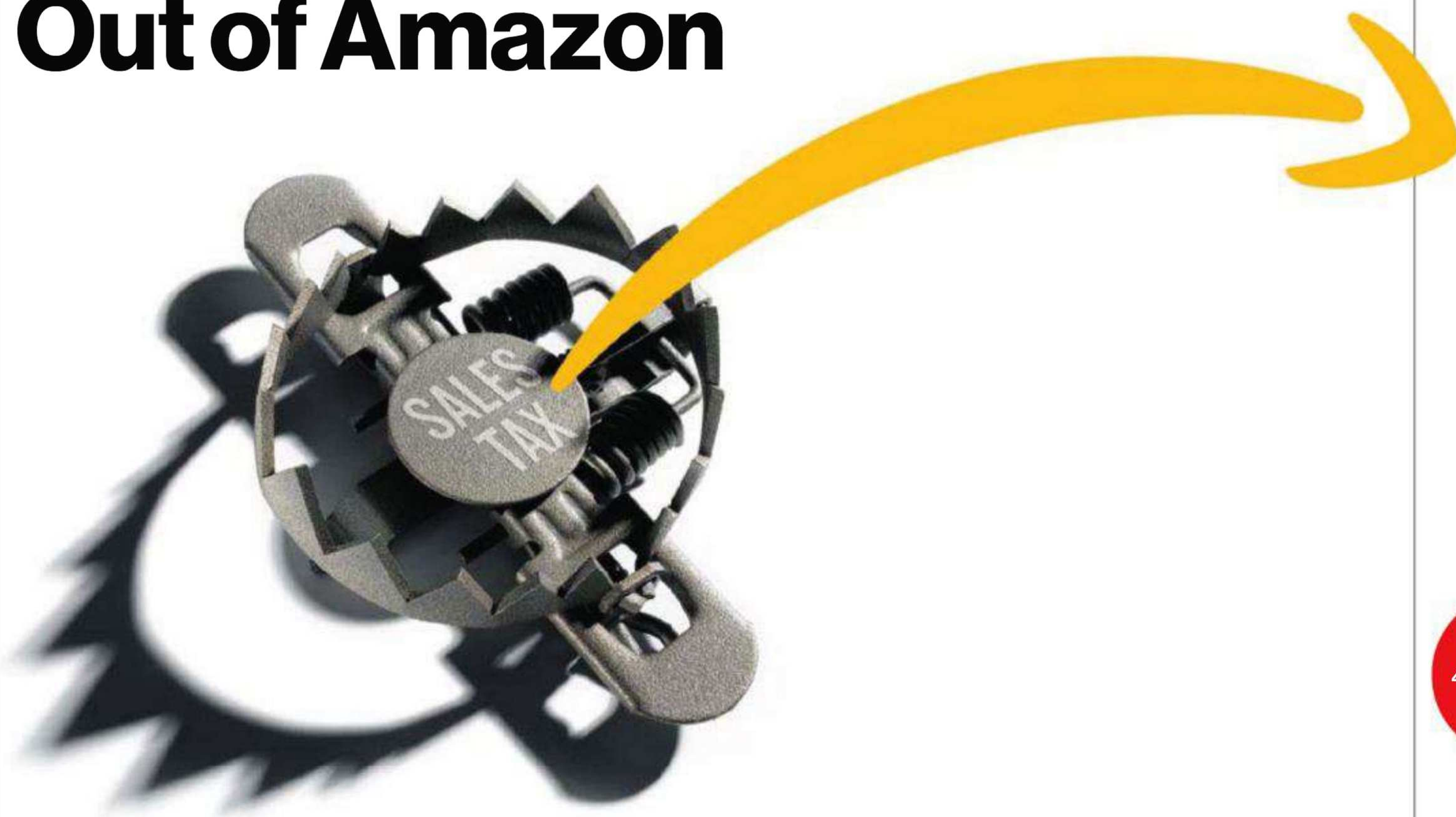
At UnitedHealthcare, we're using our experience and our access to a vast range of health care information to make health care simpler and more responsive. So that you feel like you're being treated like a human being, and your daughter can go on feeling like she's part fish. We're more than 78,000 people looking out for 70 million Americans. That's **HEALTH IN NUMBERS℠.**

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Technology

Clawing Sales-Tax Revenue Out of Amazon



▶ **A proposal in the U.S. Senate aims to end the longtime exemption for e-commerce**

▶ **"This is about how long they can push off that day of reckoning"**

California visitors to **Wal-Mart Stores**'s website must pay $214 to buy a **Philips Electronics** 22-inch LCD HDTV, one of the hottest-selling flat-panel televisions on the Web. Customers of **Amazon.com** in that state see a price of $194 for the same product. The discrepancy stems largely from something that dates back to Julius Caesar: sales tax. Wal-Mart, with about 100 stores in California, has to collect it. Amazon, with no stores in California—or anywhere else, for that matter—does not.

There's a growing sense among state and federal lawmakers that the online sales-tax reprieve, once meant to support and nurture a fledgling industry, constitutes an advantage that Amazon, with 90 million customers and $34 billion in annual sales, no longer needs. Over the past year an escalating war over online sales taxes has spread to Texas, Connecticut, California, and dozens of other states. Later this month the battle will reach Capitol Hill. Senate Majority Whip Dick Durbin (D-Ill.) says he plans to introduce a bill, called the Main Street Fairness Act, mandating that all businesses collect the sales tax in the state where the consumer resides.

Such measures have been proposed and disregarded by Congress for years, but Durbin believes the winds are shifting. "This idea is overdue," he says. "Online retail sales are now very fulsome and are growing at the expense of local units of government." Many state budgets are bleeding red, despite some recent revenue upswings around the country, and Internet sales-tax revenue has the gleam of found money. In many states, customers are supposed to declare their online purchases on their income tax forms but rarely do. A University of Tennessee study recently estimated that states will collectively lose $10.1 billion in uncollected online sales-tax revenue this year and $11.3 billion next year.

> **"Five years out, when there's probably a policy in place, it's possible Amazon will be better off for it"**

Amazon executives have long argued that state laws requiring it to collect sales tax violate Supreme Court rulings from 1967 and 1992, which stipulate that only retailers with a physical presence, or "nexus," in a state need do so. Surprisingly, Jeffrey P. Bezos, Amazon's founder and chief executive officer, recently told *Consumer Reports* that he supports federal legislation that rationalizes the patchwork of 30,000 state and local sales-tax jurisdictions around the country, each

ILLUSTRATION BY TOPOS GRAPHICS

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with its own rules and administrative quirks. Amazon declined to comment on Durbin's proposed bill.

Amazon's actions on the state level have spoken much louder than its words in support of a national solution. The company has fought state-by-state collection efforts, deploying both carrot and stick to hit politicians where they feel it most—jobs. In Texas, when the legislature passed a bill that would force online retailers with distribution facilities in the state to collect sales tax, Amazon announced it would close its shipping center outside Dallas, fire hundreds of local workers, and scrap plans to build other facilities in the state. On May 30, Texas Governor Rick Perry vetoed the bill.

In South Carolina, Amazon won an exemption on a new sales-tax law after threatening to pull its distribution center from the state and agreeing to send customers e-mails reminding them to pay the tax on their own—messages that are likely to be cheerfully ignored. On May 18 in Tennessee, legislators said they would delay considering until next year a bill that would tax online purchases. They were either spooked by Amazon's threat to move its two state distribution centers to Indiana or enticed by its new promise to evaluate locations for up to three additional centers.

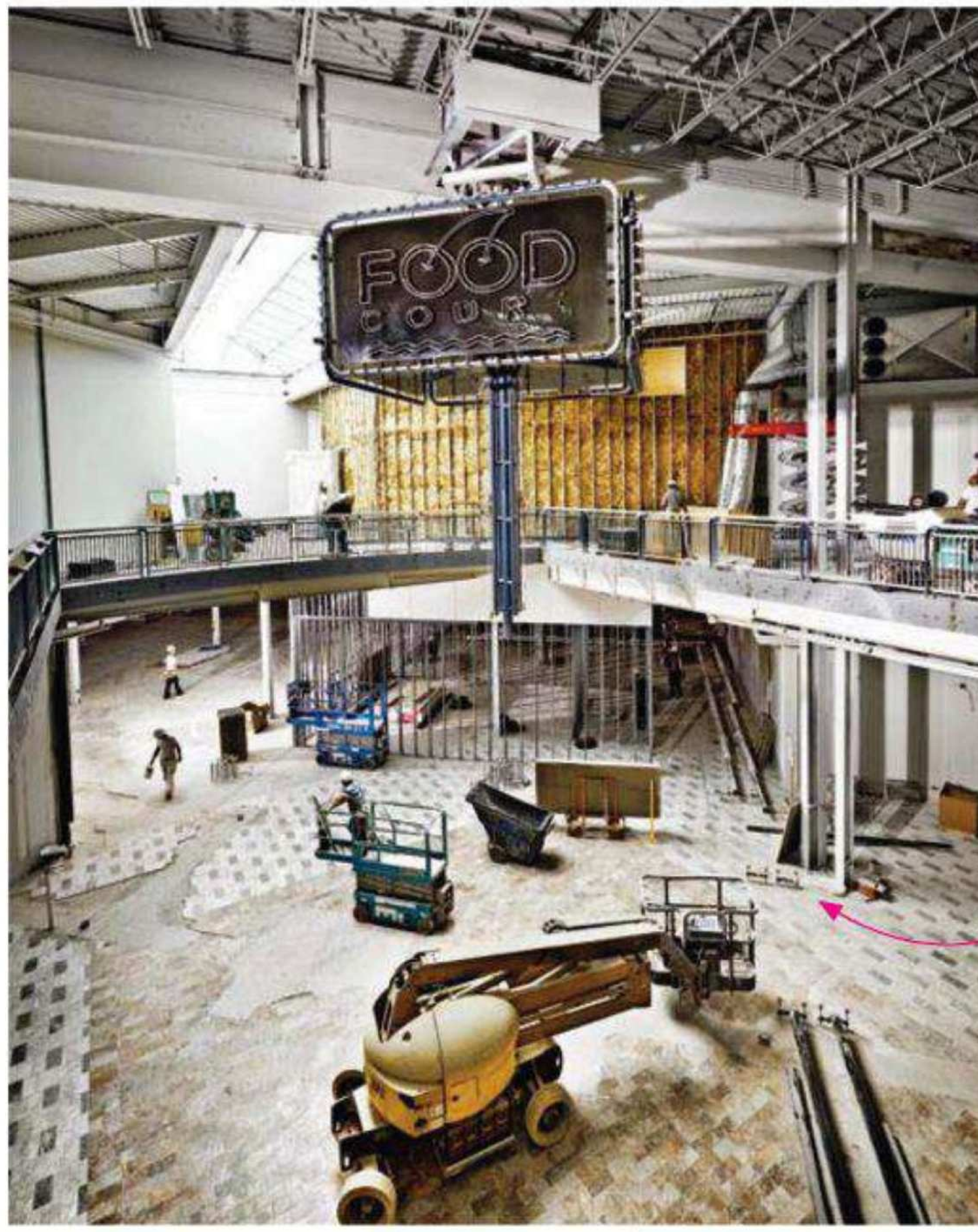
Despite the beating they've taken in these states, Amazon's opponents contend that time is on their side. "Ultimately, this is a battle they are going to lose, and this is about how long they can push off that day of reckoning," says Jason Brewer, vice-president for communications and advocacy for the Retail Industry Leaders Assn., which counts among its ranks Wal-Mart, **Best Buy**, and **Target**. They also question Bezos's professed support of a federal law. "They always claimed to support a federal solution, but they've never lifted a finger to get there," Brewer says.

Whether Congress backs a federal approach is an open question. Hill watchers believe Durbin may have a hard time garnering support for his proposal, in part because it could too easily be interpreted by voters as a new tax. "It's long been an issue the Republicans weren't interested in, and given that they're in control of the House, I don't see it going anywhere," says Pam Olson, a tax attorney at the law firm Skadden, Arps, Slate, Meagher & Flom and former Assistant Secretary for Tax Policy at the Treasury Dept.

Durbin, though, believes all those former mayors and governors now residing in Washington will weigh the budget problems back home and coalesce around the idea of a national Internet tax standard. "Doing it state by state gives the Internet companies an opportunity to go shopping, to find the state that is going to treat them the best," he says. "It certainly argues for a federal approach."

Actually, being forced to collect sales tax may not turn out to be so bad for Amazon. Analysts at **Wells Fargo Securities** recently surveyed a range of products and found that even without factoring in sales tax, Amazon's prices were, on average, 5 to 6 percent lower than Wal-Mart's and 12 to 13 percent below Target's. And without having to worry about sales-tax consequences, Amazon will be able to freely add shipping centers near every major city and accelerate its push toward delivering products overnight, or even on the day they're ordered. "Each year that passes, the relevance of sales tax to Amazon's success is less and less," says Morgan Stanley analyst Scott Devitt, who notes that the company keeps getting more efficient as it gets larger. "If you look five years out, when there's probably a policy in place, it's possible Amazon will be better off for it. That's not something I would have said before." —*Brad Stone*

The bottom line *Losing its sales-tax exemption may not hurt Amazon. Even without factoring in taxes, it beats Target and Wal-Mart on price.*





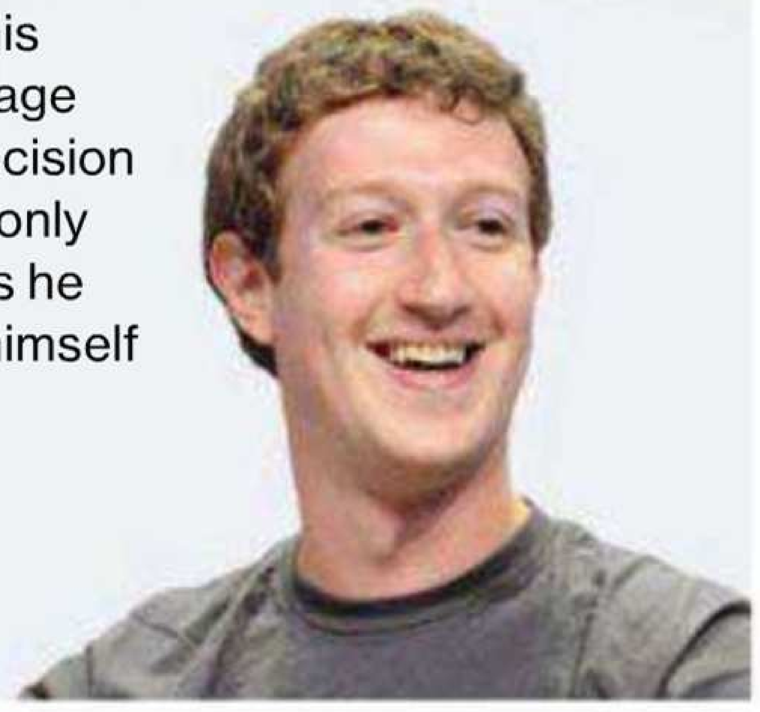
Rackspace is converting a former mall into its HQ

The chairman's office used to be a Mervyns

PHOTOGRAPHS BY JEFF WILSON FOR BLOOMBERG BUSINESSWEEK; ANTOINE ANTONIOL/BLOOMBERG

Posted

"I just killed a pig and a goat."
—Facebook founder Mark Zuckerberg, posting on his Facebook page about his decision to eat meat only from animals he slaughters himself



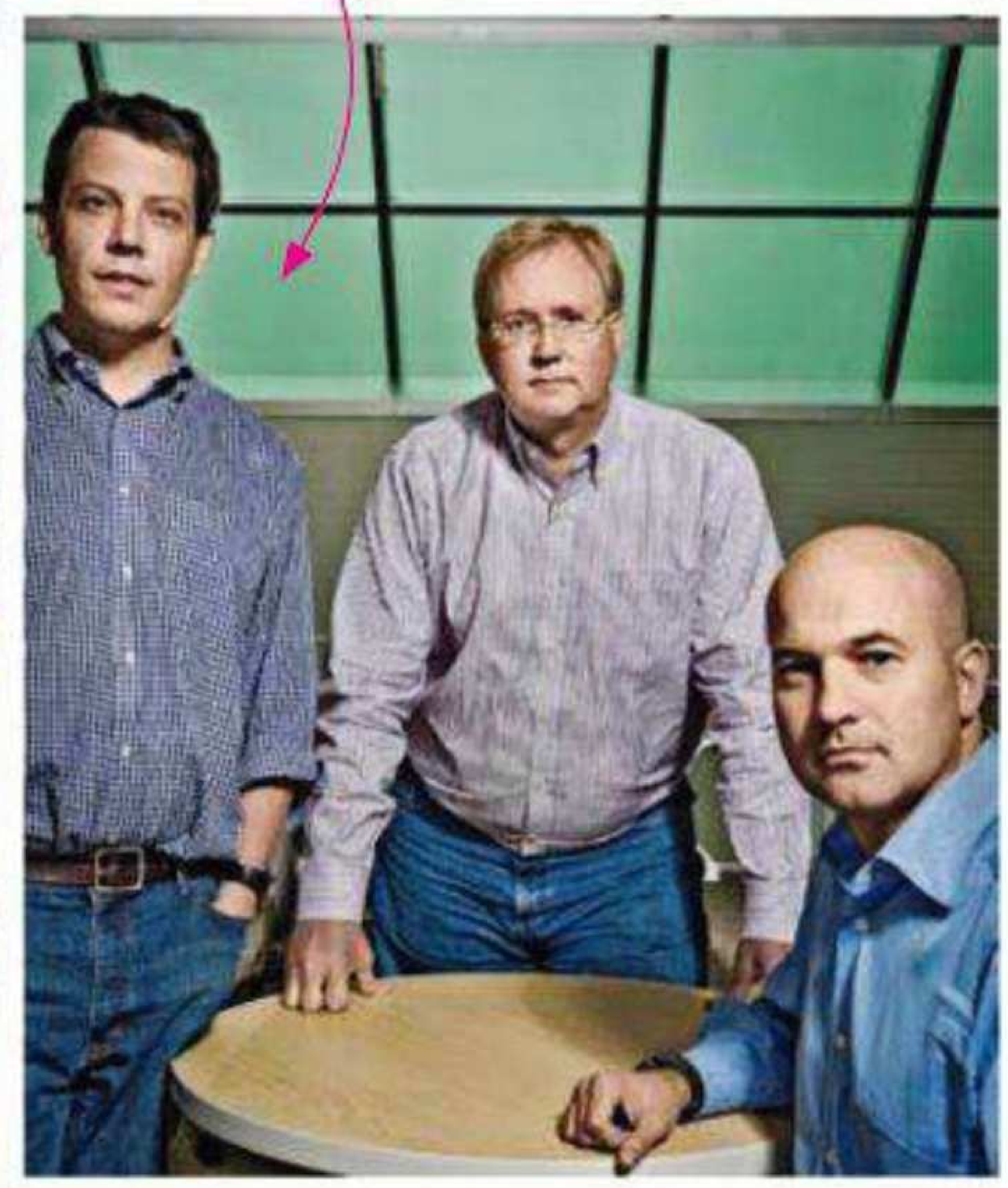
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The highest award: "Customer Service Fanatic"



The triumvirate of Moorman, Weston, and Napier





Cloud Computing

How Rackspace Beats the Behemoths

▶ The Texas company gives away software and sings *Happy Birthday*

▶ "What separates the men from the boys ... is how they communicate"

At a former mall in San Antonio, near escalators that used to shuttle Mervyns shoppers between floors, **Rackspace Hosting** Chairman Graham Weston explains a phrase his 3,500 employees have practically tattooed to their brains: "fanatical support." That's how Weston sees Rackspace beating larger, better-known competitors such as **Amazon.com** in the business of hosting others' websites and applications on servers around the world.

The 12-year-old company had a decade of near-death experiences, including a disastrous initial public offering during the 2008 financial crisis. (Its stock fell almost 20 percent on the first day of trading.) Since 2007, Rackspace's sales have grown by an average of 30 percent every year, and analysts expect net income to climb 49 percent this year, to almost $70 million. Wall Street has caught on: Rackspace shares, up almost tenfold since early 2009, are trading near an all-time high of $46 per share, valuing the company at more than $5.6 billion. Customers include 40 percent of the top U.S. companies by revenues.

Weston, 47, is an atypical tech entrepreneur. Raised on a south Texas cattle ranch, he used his penchant for finding value in distressed properties to amass a real estate empire that includes San Antonio's tallest office building. He lives on lakeside property purchased out of bankruptcy, and resides there with his wife and three kids in a double-wide trailer bought for $50,000 in a foreclosure sale. Weston built up Rackspace's infrastructure using the same skills: When the dot-com bubble burst, he snapped up three empty data centers for pennies on the dollar. To accommodate the company's growth, Weston paid $32.7 million for the abandoned Windsor Park Mall, which has 1.2 million square feet of space.

Real estate acumen won't help much with Rackspace's biggest challenges, namely, wooing in-demand programmers and stretching its relatively small cash hoard ($134 million, vs. Amazon's $8.76 billion) in a capital-intensive business. Weston and his chief executive officer, Lanham Napier, see customer service as Rackspace's key competitive advantage. Employees have been known to have pizza delivered to customers who are working late or sing *Happy Birthday to You* via speakerphone. The highest internal award for employees is a straitjacket with the words "Customer service Fanatic" on the front. "It's man vs. machine," says Weston of the difference between Rackspace and its rivals. "We have to become one of the most trusted people in our customers' lives."

Rackspace says the contrast is most apparent when disaster strikes. When Amazon's cloud-hosting service crashed in April, some found the Seattle company's response lacking. "They could've communicated better while it was happening," says Christopher Ahlberg, who received a two-week credit and an apology letter from Amazon when his data analysis startup, Recorded Future, went down. An Amazon spokeswoman says the company "identified improvements that need to be made in our customer communications" and is now implementing them.

When Rackspace lost power in 2007, employees called thousands of customers to apologize, explain the situation, and promise refunds. "What separates the men from the boys in this world is how they communicate," says Sean Andersen, director of interactive services

Where Coke's shares are headed
page 49 ▶



for **Six Flags Entertainment** and a Rackspace customer who says he was wholly satisfied with the company's response to the 2007 outage.

Rackspace is so insistent on customer experience as a competitive advantage that it's willing to give away its technology. The company spent three years building software tools to make it easier to set up cloud-storage systems. Last year it made the source code freely available as part of a project called OpenStack. It's a big risk: **Dell** and **Citrix Systems** have said they will be selling systems based on OpenStack that could compete with Rackspace's offerings. Yet managing those systems still requires expertise, according to Lew Moorman, Rackspace's chief strategy officer and the president of its cloud unit. The company's betting that OpenStack users will hire Rackspace to do it for them. "Ultimately, we want to make it a better experience and not a technology game," Moorman says. "We think we're going to do it better than others." —*Ari Levy*

The bottom line *Its stock near an all-time high, Rackspace is giving away software in hopes of wooing new customers to its suite of services.*

Mobile Commerce

Grilled Cheese? There's An App for That



▶ The Flip camera creator's post-Cisco gig: High-tech fast food

▶ "It's disappointing, absolutely," he says of Cisco's move to kill the Flip

Jonathan Kaplan is the creator of Flip Video, that sublimely simple pocket-size camcorder that jumped off the shelves in consumer electronics stores over the past five years. Now, Kaplan is cooking up something new: grilled cheese.

Kaplan sold his firm, Pure Digital Technologies, to **Cisco Systems** for $590 million in 2009, then left the company earlier this year, right before Cisco closed down the Flip unit in April along with its entire consumer division. Kaplan's new startup is one of the oddest ideas to come out of Silicon Valley in years. It's called **The Melt**, and the grand plan is to start a nationwide chain of restaurants offering nothing but five variations on the old lunchtime standby, along with a hearty accompanying soup.

Kaplan wants to extend the popularity of grilled cheese outside of elementary school cafeterias and smoky college dorm rooms, and he's enlisted some formidable help in the kitchen and the boardroom. Celebrity chef Michael Mina is assisting with the menu and sits on The Melt's board of directors, along with Ron Johnson, **Apple**'s senior vice-president for retail, and **Sequoia Capital** partner Mike Moritz, an early investor in **Google**. "People have a reaction to grilled cheese that is different than other food groups and is more similar to chocolate than hamburger," Kaplan says. "They talk about loving grilled cheese, they don't talk about liking it."

Kaplan wants to build a fast-casual dining chain along the lines of **Chipotle Mexican Grill**, with its 1,000-plus restaurants and $9 billion market cap, but with a basic menu that rivals the Flip camera in its simplicity. Restaurants will have five soup-sandwich combinations on the menu, such as the Classic (cheddar on potato bread with tomato soup) and the Mission (pepper jack on sourdough, with a roasted corn and tortilla soup). Kaplan's chefs are also working on more gourmet options, like a goat cheese and mint sandwich with carrot ginger soup. Each combo will cost $7.95. Kaplan won't discuss the exact amount of funding he's raised but says he's got enough to introduce five restaurants in the San Francisco Bay Area by Thanksgiving of this year and 25 around the country by the end of next of year. "If we always did what was expected of us, we'd still be investing in 8-inch disk drives," says Sequoia's Moritz, who grew up in Wales eating a grilled cheese equivalent called the "chip butty"—a French fry sandwich. "This is a company that, if all goes well, could become very large."

Kaplan has seasoned the grilled cheese with a dash of high tech. He

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Innovator

Spin Doctor

Mahawili's compact turbines can sit on rooftops





Entrepreneur Imad Mahawili has built a lightweight wind turbine that may generate two to three times more electricity than similar models

In December 2004, Imad Mahawili was vacationing with his family in Florida when an earthquake near Indonesia triggered a tsunami that killed more than 200,000 people. Watching the destruction of poor villages in Asia and Africa on TV, Mahawili was reminded of the poverty he experienced as a child growing up in Baghdad in the 1950s. "It was heartbreaking," he says.

Mahawili, 62, was then executive director of the Michigan Alternative & Renewable Energy Center (Marec), a nonprofit that helps entrepreneurs launch green startups. But the tsunami had given Mahawili, a serial entrepreneur who holds a PhD in chemical engineering and had sold two technology companies, an urge to build something that could benefit the poor. In 2006 he started working on an idea for a small, inexpensive wind turbine that could provide electricity to rural communities. Three years later he left Marec to found WindTronics in Muskegon, Mich.

In most turbines, wind spins a three-blade system, which turns a vertical shaft that connects to an electrical generator at its base. In contrast, Mahawili's design looks like a giant bicycle wheel with 20 nylon spokes. At the outer end of each spoke is a magnet and stationary coil, which generate electricity. Because the electricity is created in the blades themselves and not by spinning a heavy shaft, Mahawili's design can capture two to three times as much energy as traditional models, according to Honeywell International. The conglomerate tested Mahawili's design as part of a worldwide search for energy-efficient turbines, and it "really stood out," says Tony Uttley, a Honeywell vice-president. The turbine is small and light enough to sit on a roof; five could power an average U.S. household.

C.P. van Dam, director of the California Wind Energy Collaborative research center at the University of California at Davis, has studied the design and says he doubts it captures as much energy as advertised, "at least as it's presented to us right now." The marketplace will get a chance to decide when Honeywell begins selling the device under its own brand later this year. Each turbine costs $5,795 plus installation, and Mahawili hopes Honeywell's global reach will help persuade governments to purchase it for rural towns.

The youngest of eight children of an Iraqi bureaucrat, Mahawili scored high enough on national exams in 1960 to enter an exclusive Baghdad high school run by Boston College Jesuits. He excelled at the school and in 1968 left to study in England, where he earned his doctorate at Imperial College London. He came to the U.S. in 1974 to work for Dupont. His guiding principle through it all: "survival through education and performance." *—Antone Gonsalves*

Childhood ▶ **Son of an Iraqi bureaucrat; grew up in Baghdad**

Inspiration ▶ **The "heartbreaking" 2004 tsunami**

Innovation ▶ **A small wind turbine that Honeywell will sell for $5,795**

Technology

worked with Swedish appliance maker **Electrolux** to develop a specialized oven—part microwave, part induction burner—that supposedly can prepare two "perfectly toasted" sandwiches in less than a minute. The Melt also exploits some Valley buzzwords: local, social, and mobile commerce. The company will tweet its specials, and Kaplan says The Melt is working on smartphone apps. When a customer orders a meal online, the restaurant will be able to track their location and pop their sandwich into the oven when they're nearby, enabling the customer to pick up a hot lunch without waiting in line.

Kaplan is focused on The Melt, but hasn't forgotten the untimely demise of Flip Video. When Cisco announced it would stop selling the Flip in April, many fans and critics wondered why the company didn't simply find a buyer for Pure Digital, since the devices were still selling briskly. Kaplan says he was contacted by many bankers and private equity firms soliciting his help in acquiring the Flip assets. While he concedes it would have been a "nightmare" for Cisco to license back Flip technology it had already integrated into its products, he still sounds crestfallen. "I'm not John Chambers," he says of Cisco's CEO. "I had a whole different set of priorities and dreams and hopes when I joined Cisco. It's disappointing."



Cisco discontinued the popular line of Flip Video cameras in April

But then he's back to talking about The Melt, and unlocking a hidden reservoir of nostalgia that he believes people have for melted cheese on toasted bread. "Both the Flip and The Melt are all about making memories," Kaplan says, spreading the *fromage* a bit thick. "When I think about having a billion people eating grilled cheese, I think about a billion happy people." Ⓑ
—Brad Stone

The bottom line *Kaplan's new chain of grilled cheese restaurants hits all the buzzwords: It's local, social, and will come with a smartphone app.*

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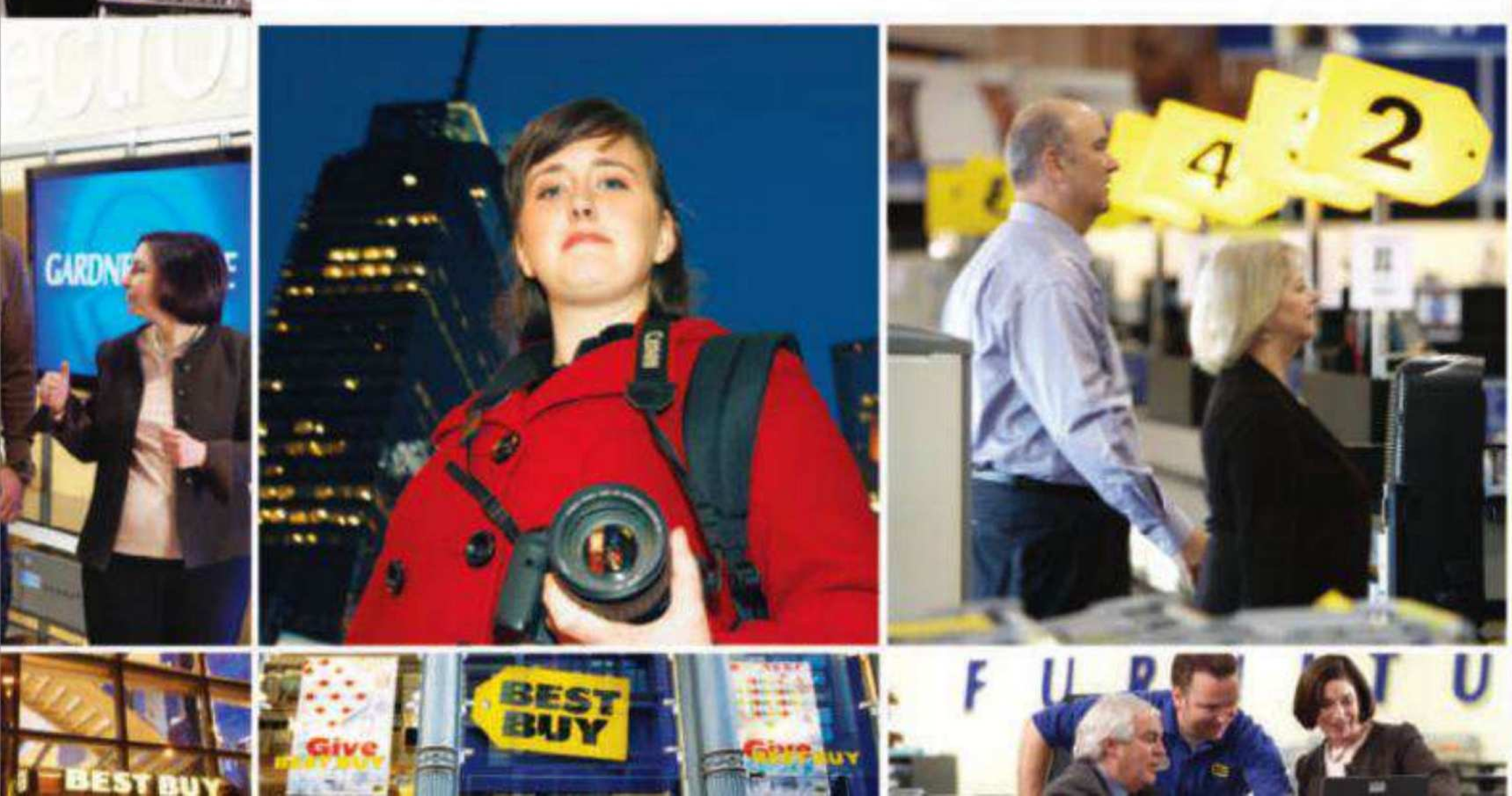
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Can Coke Surpass Its Record High of $88 a Share?

▶ **The surging stock is still 31 percent below the peak it reached in 1998**

▶ **"It's got a really top-notch fellow running the company now"**

Coca-Cola Chief Executive Officer Muhtar Kent will tell you he doesn't pay any attention to the company's share price. "We do the right thing, and our share price manages itself," he says. His predecessor, E. Neville Isdell, often said the same thing. Today, Isdell, who stepped aside as CEO in 2008, admits that he obsessively checks the stock on his BlackBerry.

The stock's $87.94 high-water mark on July 14, 1998, still haunts company headquarters in Atlanta. The five-year decline that brought shares to $37 in March 2003 reflected the turmoil within, as the company struggled with bloated costs, management upheaval, and a loss of focus on its core product, soda pop. Coca-Cola has been addressing those problems, and after a setback during the recent global recession, its shares on May 19 hit $68.46, the highest level in more than a decade. Yet even as it improves operations, the company is unlikely to generate the exuberant support from investors that propelled the stock in the 1990s, and some money managers who own the shares say it will be two years or more before they surpass the high established 13 years ago.

Coke began the slow climb out of its hole in 2004, when the directors lured Isdell, who had held high-

➜



ranking positions at the company, out of retirement to be CEO. In a strategy that came to be known as "Red, Black, Silver," Isdell refocused the company–which had been giving priority to noncarbonated drinks–on its core products, Coke (Red), Diet Coke (Silver), and, starting in 2005, Coke Zero (Black). Executives pushed supermarkets to give them prominent display and more shelf space. Isdell also put in place a succession plan that led to Kent taking over as CEO in July 2008.

Kent, 58, got to work on Coca-Cola's U.S. operations. He introduced 7.5-ounce minicans that sell for about $3.50 for an 8-pack, aimed at people who want to control their soda portions, and 16-ounce bottles priced at 99¢. Both sizes fetch higher per-ounce prices than the standard 20-ounce bottles in convenience stores and 2-liter bottles in supermarkets, where competition keeps prices low. Last year, Kent purchased the company's largest franchised bottler, giving the company control of 90 percent of its U.S. and Canadian distribution.

Kent also reconfigured serving sizes globally to meet shifting consumer demands and boost profit margins. Since March 2009, he's promised to spend at least $27 billion through 2020 for new plants and distribution facilities in emerging markets, including Mexico and China. Coca-Cola gets nearly 80 percent of its sales outside the U.S.

"It's just a matter of grinding it out," says Yacktman, who sees the stock hitting a new high in five years

The moves are having an impact. The company has posted four consecutive quarters of sales growth by volume in North America. Last year, Diet Coke surpassed Pepsi-Cola as the second-best-selling soft drink in the U.S., according to data from trade newsletter *Beverage Digest*. Coca-Cola remained No. 1. The company's profit margin grew to 22 percent in 2009, up from 18 percent in 2008. By comparison, **PepsiCo**'s profit margin was about 14 percent in 2009, up from 12 percent the previous year.

Coca-Cola's stock rose 30 percent in the year ended May 31, outpacing PepsiCo's 13 percent and the Standard & Poor's 500 Consumer Staples Index's 23 percent. Coca-Cola's price-earnings ratio stands at about 19, modest by historical standards. At the 1998 high, Coca-Cola's shares were trading at almost 48 times the company's annual earnings, reflecting investors' willingness to pay a premium to own what they saw as a reliable growth stock. "It had a p-e that turned out to be unjustified," says Douglas Lane, president of New York-based Douglas C. Lane & Associates, whose clients hold more than 600,000 Coke shares.

So when will Coca-Cola get back to $88, a 31 percent climb from $67, its May 31 closing price? In the short term, Coca-Cola faces volatile commodity costs that could force it to raise prices at a time when consumers may balk, says Lauren Torres, an analyst for HSBC Securities. She estimates Coca-Cola will trade at $71 a year from now.

Lane says a new high will come in two to three years. He expects Coca-Cola's profit to rise 10 percent to 12 percent annually during that time–respectable, but below the rates the company enjoyed in the mid-1990s. Assuming Coca-Cola's p-e ratio stays at 19, the earnings gains would imply a stock price of $90 in 2013. "It's still a relatively inexpensive stock," Lane says. "It has broad positions globally, it's broadened its product line, and it's got a really top-notch fellow running the company now."

Donald Yacktman, whose **Yacktman Asset Management** holds 11.9 million Coca-Cola shares, estimates it will take five years for the stock to reach a new high. "It's just a matter of grinding it out," he says. Carlos Laboy, an analyst for Credit Suisse, is far more optimistic. In a note to clients in May, he estimated Coca-Cola's shares will hit $95 in a year. "We believe KO's U.S. business is reaching an inflection point," he wrote, referring to the company by its stock symbol.

Isdell, retired again and traveling the globe speaking about corporate sustainability, smiled recently when asked for his best estimate of when the stock would surpass its 1998 high. "Eighty-eight is a funny number," he said. "What you have to do is look at the fundamentals, and I think eventually you're going to get there." —*Duane D. Stanford*

The bottom line *While Coca-Cola stock has rallied 30 percent over the past year, some analysts and investors predict a slow climb to its 1998 record.*

Private Equity

Buyout Firms Branch Out to Grow

▶ Diversification means anything from hedge funds to strip malls

▶ "We're building new products and adding new geographies"

Stephen A. Schwarzman, David M. Rubenstein, Henry R. Kravis, and George R. Roberts became billionaires by engineering leveraged buyouts. Now they're transforming their companies into asset managers that run everything from hedge funds to strip malls as fresh capital and takeover targets become scarce.

Schwarzman's **Blackstone Group**, the biggest private equity firm, is earning twice as much from owning prop-



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A phone giant's Hail Mary page 56 ▶

erty, including office buildings in India and seniors communities in Oregon, as from buyouts. Kravis and Roberts's **KKR** owns a stake in a 5,500-mile U.S. fuel pipeline and lends to distressed companies. "The large-cap leveraged buyout business has become mature," says Colin C. Blaydon, director of the Center for Private Equity & Entrepreneurship at Dartmouth College's Tuck School of Business. In the future, private equity firms will look "more like the large money-management enterprises, with a big emphasis on assets under management."

The firms have little choice if they want to grow. For one thing, the increase in the number of buyout funds—to 470 today from 60 in 1990—has made raising money harder. "As the business exploded, more and more people rushed into private equity, which made competition for money fierce," says Richard I. Beattie, chairman of law firm Simpson Thacher & Bartlett, who helped KKR with its $30 billion takeover of RJR Nabisco in 1989 and remains an adviser to many private equity firms.

Stock prices have doubled in a two-year rally, making takeover candidates more expensive. And while deal activity is increasing, private equity firms are encountering more competition from corporate buyers with lots of cash. Blackstone, which is raising a $15 billion fund, committed only $550 million to private equity deals in the first quarter.

Blackstone's largest investment in the last 12 months was the $9.4 billion deal to buy 593 U.S. shopping centers in 39 states from Australia's **Centro Properties Group**. It would be the largest cash purchase of real estate in the world since the collapse of Lehman Brothers in 2008, Schwarzman, 64, said during an April conference call with investors.

Co-founder Rubenstein has steered Washington-based **Carlyle Group**, ranked second by assets under management, into the fund-of-funds business by taking over AlpInvest, a Dutch company that spreads money for investors among buyout funds. Rubenstein, 61, also agreed to buy a majority stake in **Claren Road Asset Management**, a hedge fund that trades debt. "We're building new products and adding new geographies and people to give our clients more choice and asset-diversification options," he says.

KKR, created in 1976 by Kravis, Roberts, and Jerome Kohlberg, has ventured into underwriting stock and bond offerings, investing in infrastructure deals, making and buying loans, and, most recently, operating hedge funds.

Leon D. Black's **Apollo Global Management**, which completed a $565 million initial public offering in March, has been scouring European banks for what it calls "stranded assets," including $2 billion of nonperforming commercial loans, President Marc A. Spilker told investors on May 12. Another $240 million is earmarked for "longevity-based assets"—a bet on the value of life insurance policies Apollo is buying from banks.

These private equity managers are trying to boost returns by going where rivals can't because they lack the firepower, or by taking advantage of distressed sellers. "In virtually all recent transactions, Blackstone has faced limited competition due to the magnitude of capital required and the complexity of the transactions," Schwarzman told investors in April.

Even so, private equity firms may not find asset management and real estate as profitable as buyouts. Private equity firms typically collect a 1.5 percent to 2 percent fee on assets under management and incentive fees equal to 20 percent of any profit. While the new businesses may produce comparable management fees, they can offer little or no incentive fees.

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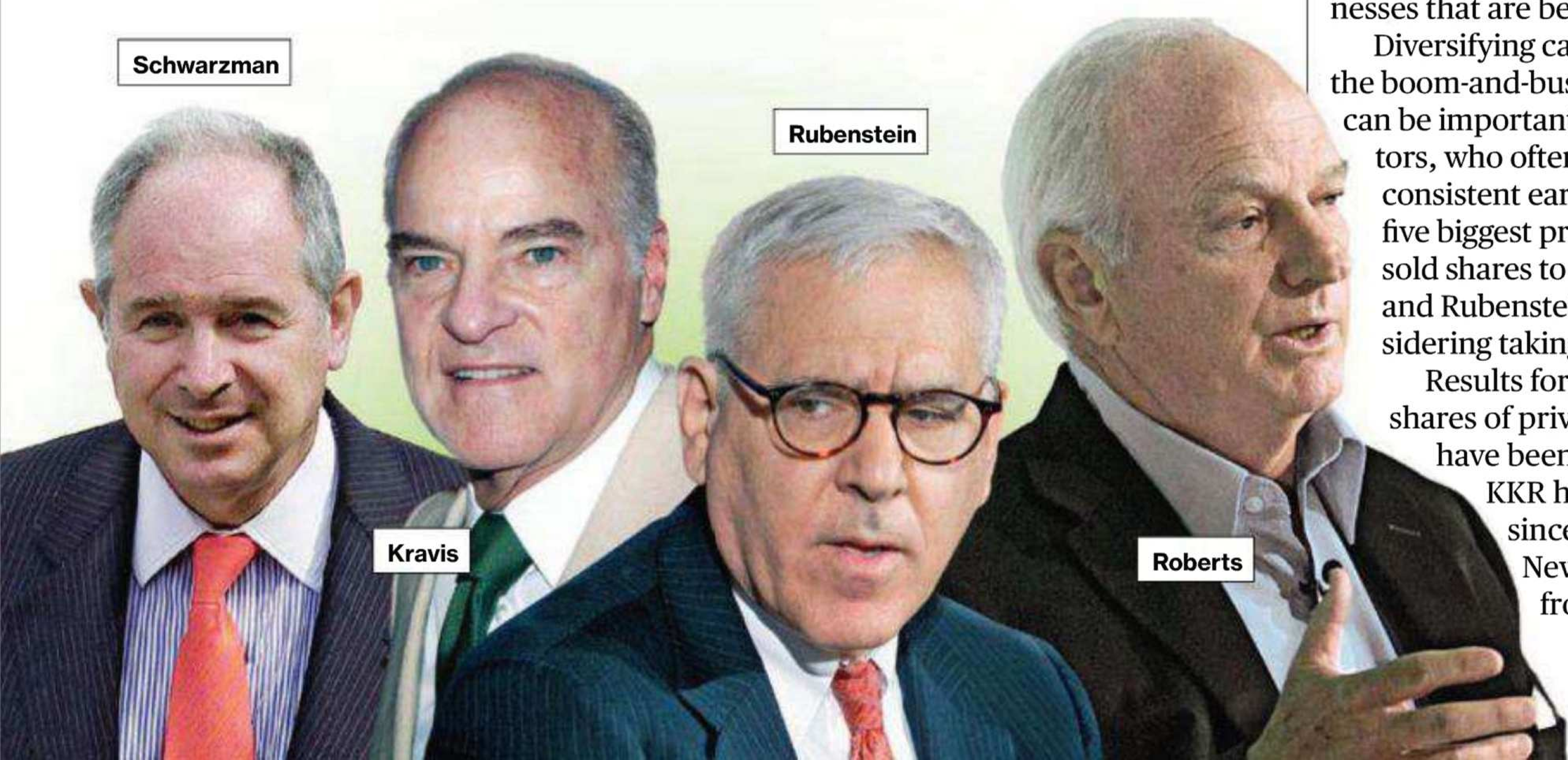
The number of buyout funds operating today, up from 60 in 1990

One Blackstone fund specializing in commercial loans and junk-rated debt charges an average 1.2 percent annual management fee and gets no incentives for good performance. Carlyle's AlpInvest, which has more than $57 billion in assets under management according to its website, generated about $86 million in 2009 revenue, which included management and incentive fees.

Carlyle's Blue Wave Partners, the firm's first hedge fund, launched in 2007 and saw assets drop by a third, to $600 million, by 2008, as the market for mortgage securities froze. Apollo's real estate unit posted a first-quarter loss this year that the company said was tied to the purchase of Citi Property Investors from **Citigroup** in November. "It's not hard to start or buy other businesses," says Blackstone President Tony James. "What's hard is creating businesses that are best at what they do."

Diversifying can be a way to smooth the boom-and-bust cycle of LBOs. That can be important to stock market investors, who often favor companies with consistent earnings. Three of the five biggest private equity firms have sold shares to the public since 2006, and Rubenstein said in May he's considering taking Carlyle public.

Results for investors who buy the shares of private equity companies have been mixed. As of May 31, KKR has gained 64 percent since it shifted its listing to New York last year from Amsterdam, ➔



BLOOMBERG (4)

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where its publicly traded European entity had lost more than half its value since 2006. While Blackstone has gained 62 percent in the past 12 months, its shares are still 44 percent below the IPO price. Apollo, which this year moved its listing to the New York Stock Exchange from a private exchange run by **Goldman Sachs**, is down 5.2 percent since March.

As they offer shares to the public, private equity firms may face skepticism from investors concerned that they are selling at a high point in the market. Says Harold Bradley, chief investment officer of the Ewing Marion Kauffman Foundation in Kansas City, Mo., which promotes entrepreneurship: "When the smart money is selling, I'm not convinced investors should be paying up."
—*Cristina Alesci and Jason Kelly*

The bottom line *The quest for new sources of revenue leads private equity firms into businesses that, while steadier, may be less profitable.*

Investigations

Grilling Taxpayers on Offshore Accounts

▶ The U.S. seeks information from people who sought amnesty

▶ "This is the biggest tax investigation ever in the country"

In 2009, as U.S. prosecutors were bearing down on Swiss bank **UBS** to disclose the names of tax cheats, thousands of wealthy Americans decided it was best to avoid prosecution and come clean with the Internal Revenue Service. Under a limited amnesty program, they disclosed their secret offshore accounts and paid the taxes they owed, along with the reduced penalties that were part of the deal. They also agreed to turn over records and cooperate with the IRS.

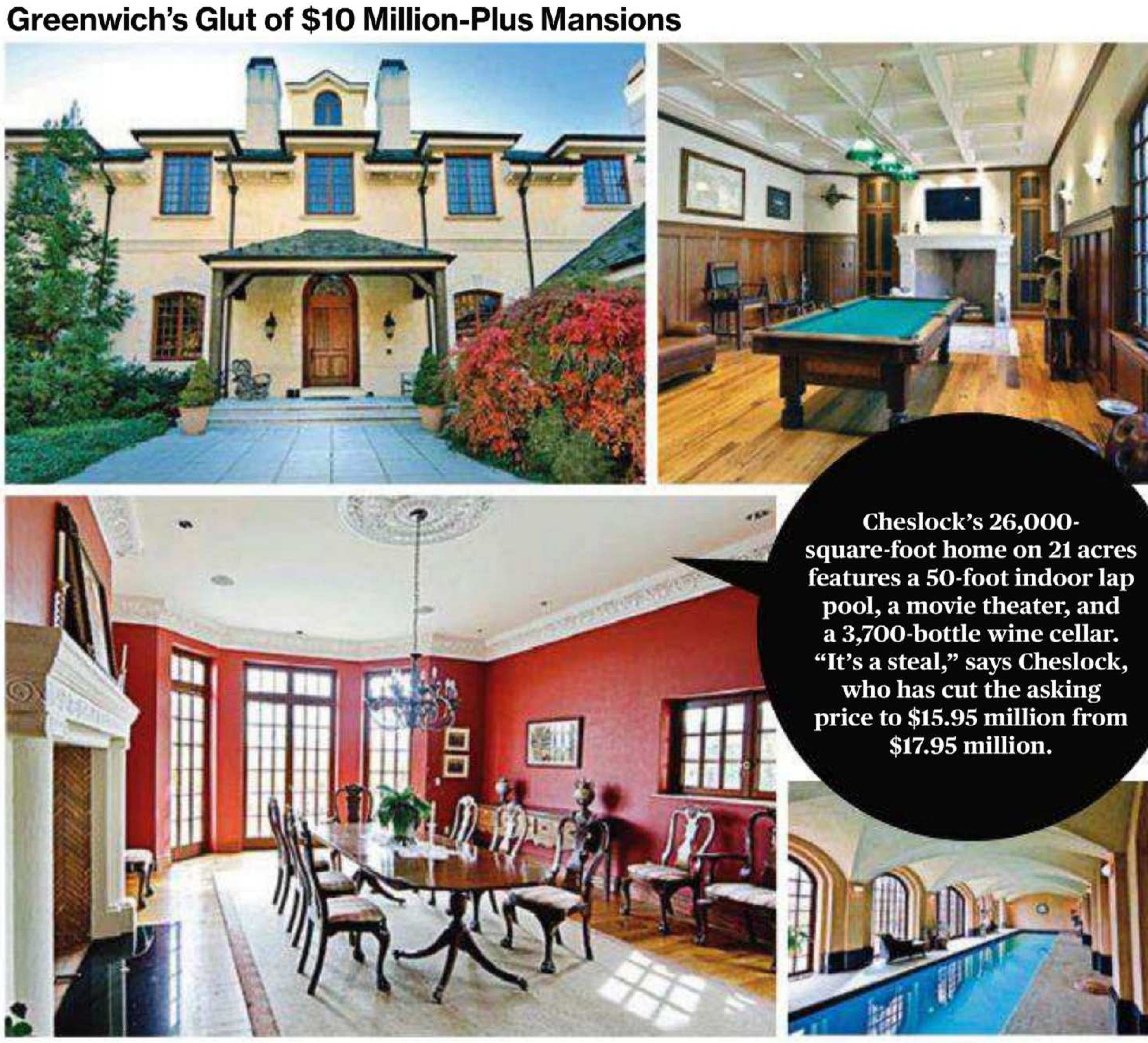
Now, IRS agents and federal prosecutors are going back to some of those same people to milk them for more information on the bankers and advisers who helped them hide their money. So far, more than 200 offshore-bank clients have been questioned in what lawyers call a crackdown of unprecedented scope. The questions that taxpayers answered helped form the basis of an indictment of four Europe-based bankers at **Credit Suisse** in February, and a U.S. civil action against **HSBC**, according to people familiar with the matter. "This is the biggest tax investigation ever in the country, both in terms of the numbers of people and the money involved," says Robert S. Fink of Kostelanetz & Fink in New York, a tax lawyer for 43 years. "They are looking at what I call the enablers." Fink represents nearly 40 people contacted by investigators. "HSBC does not condone tax evasion. It fully supports U.S. efforts to promote appropriate payment of taxes," says HSBC spokeswoman Juanita Gutierrez.

On the telephone or in face-to-face sessions, more than 100 federal prosecutors are pressing the taxpayers to cough up details about who helped them set up their accounts, how they moved their money, and where they met their advisers, according to two people involved in the probe who aren't authorized to speak about the matter. People who don't cooperate could be prosecuted for their tax crimes. IRS spokesman Dean Patterson didn't respond to questions about the investigation.

A New Jersey physician who disclosed his offshore account in 2009 found out from his lawyer in January that the IRS wasn't done with him yet. The doctor, who spoke on condition that he not be identified, took sole control of about $750,000 in a UBS account in Zurich when his mother died in 2002. He says that in October 2008, his UBS banker told him to close his account, by then reduced to about $275,000. The doctor flew to Zurich, where his banker gave him the names of two banks that he was told would hide his account from the IRS. The doctor chose **Basler Kantonalbank**, a regional Swiss bank.

By late 2009, he feared that UBS would give his name to the IRS as part of a settlement with the government. He joined the voluntary disclosure program and ended up paying $250,000

Greenwich's Glut of $10 Million-Plus Mansions



Cheslock's 26,000-square-foot home on 21 acres features a 50-foot indoor lap pool, a movie theater, and a 3,700-bottle wine cellar. "It's a steal," says Cheslock, who has cut the asking price to $15.95 million from $17.95 million.

It's been more than 500 days since Stanley Cheslock put his Greenwich (Conn.) mansion up for sale. It's one of 52 priced at $10 million and above on the market in the hedge fund capital about 30 miles northeast of New York City, the biggest backlog since at least 2004, according to Mark Pruner, an agent with Prudential Connecticut Realty. Four in that range have sold this year, and two are in contract. —Oshrat Carmiel

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54.6

The euro-zone manufacturing Purchasing Manager's Index in May, down from 58 in April to a seven-month low.

DATA: MARKIT ECONOMICS

in back taxes, interest, penalties, and legal fees. In February a prosecutor and two IRS agents questioned him over the phone for 40 minutes, homing in on his dealings with Basler Kantonalbank. The doctor says he later received a letter from the IRS telling him the matter was closed.

Most of the people being questioned came to the attention of the IRS after UBS, Switzerland's largest bank by assets, was criminally charged in February 2009 with helping Americans evade taxes. The bank avoided prosecution by paying $780 million, admitting it fostered tax evasion, and agreeing to give data to the IRS on more than 250 accounts. UBS later handed over data on an additional 4,400 accounts to resolve a civil suit brought by the IRS.

As it was pursuing UBS, the U.S. also began flushing out bank clients who had been squirreling away money in offshore havens such as Liechtenstein, Hong Kong, and Panama. From March to October 2009, 15,000 taxpayers came forward under the IRS's voluntary disclosure program. After October 2009, some 4,000 more joined the program. To avoid prosecution, the taxpayers had to disclose their offshore accounts, bankers, and advisers, as well as how they moved their money. The results are what's feeding the current investigation. "We are mining the information we have received to date and have launched our next wave of investigations on banks, bankers, intermediaries, and taxpayers," IRS Commissioner Douglas H. Shulman said in a May 18 speech.

Prosecutors are particularly focused on how money moved out of undeclared accounts at UBS in 2008 and 2009 and into smaller banks "to escape detection," says Scott D. Michel, an attorney at Caplin & Drysdale in Washington. He represents more than a dozen clients called by the Justice Dept. or IRS.

Lawyers for some of the people questioned say prosecutors and IRS investigators have asked about their dealings with the Swiss bank **Julius Baer Group**, Swiss regional banks such as Basler Kantonalbank, and several Israeli banks, including **Bank Leumi le-Israel** and **Bank Hapoalim**. Spokesmen for Julius Baer and Basler Kantonalbank declined to comment. "We are not involved in this matter," says Bank Hapoalim spokeswoman Ofra Preuss. Bank Leumi spokesman Aviram Cohen says, "We have not been informed by the authorities of an investigation being conducted against the bank."

In the indictment of the four Credit Suisse bankers, the government accuses them of conspiring to help U.S. clients evade taxes. The bankers have not yet appeared in court. In the fall of 2008, the bank had "thousands" of accounts with $3 billion in assets not declared to the IRS, according to the indictment. "Credit Suisse is not a target of the investigation," says spokesman David Walker. "We will continue to cooperate fully with the authorities."

Since 2007, when the investigations into offshore tax evasion began, the U.S. has criminally charged at least two dozen UBS clients with tax crimes, as well as four UBS bankers, two HSBC clients, and four other offshore enablers. And as the feds continue to squeeze bank clients, others are likely to feel the heat, according to lawyer William M. Sharp Sr. of Sharp Kemm in Tampa. "It's the first act of a multi-act play," says Sharp, who has two dozen clients who have been interviewed. "It's going to go on for a long time, probably four or five years." *—David Voreacos*

The bottom line *IRS agents and prosecutors have interviewed more than 200 offshore-bank clients to learn who helped them avoid taxes.*

Careers

Finding Daring Jobs For Bored Bankers

- Escape the City caters to people looking for more than money
- Inspired by "our own feelings of misery and frustration at work"

Rob Symington and Dom Jackman weren't loving their jobs at consulting firm **Ernst & Young** in the City of London. "It felt like the work we did, crunching spreadsheets, just didn't matter to anyone, including to our customers or employers," says Symington, 27. Reasoning that they



Way beyond spreadsheets: Howe, Symington, and Jackman

FROM LEFT: HIGGINS GROUP REAL ESTATE VIA BLOOMBERG(4); SIMON DAWSON/BLOOMBERG

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might not be the only young people in the City having second thoughts about their chosen careers, in 2009 Symington and Jackman, 28, quit and founded **Escape the City**, a website dedicated to helping bored finance workers shake up their lives by taking jobs with Mongolian venture capital firms, African charities, and other far-flung employers.

More than 30,000 people have signed up to view the listings at Escape the City in London—registration is free—and now Symington and Jackman plan to open a branch in New York this month. “Escape the City was created specifically to help talented people escape from unfulfilling corporate jobs after we realized that our own feelings of misery and frustration at work were shared by a lot of people,” says Symington. “We stumbled upon a business opportunity by following a hunch about job dissatisfaction to its logical conclusion.”

Escape the City charges employers for listing jobs, which must meet its criteria of offering adventure and requiring enterprise. Symington says the company was profitable in its first year. It sends members weekly e-mails listing opportunities in everything from Indian microfinance to Moroccan surf camps, and encourages wanderlust with evening events where adventurers regale crowds with tales of skateboarding across Australia or cycling around the world.

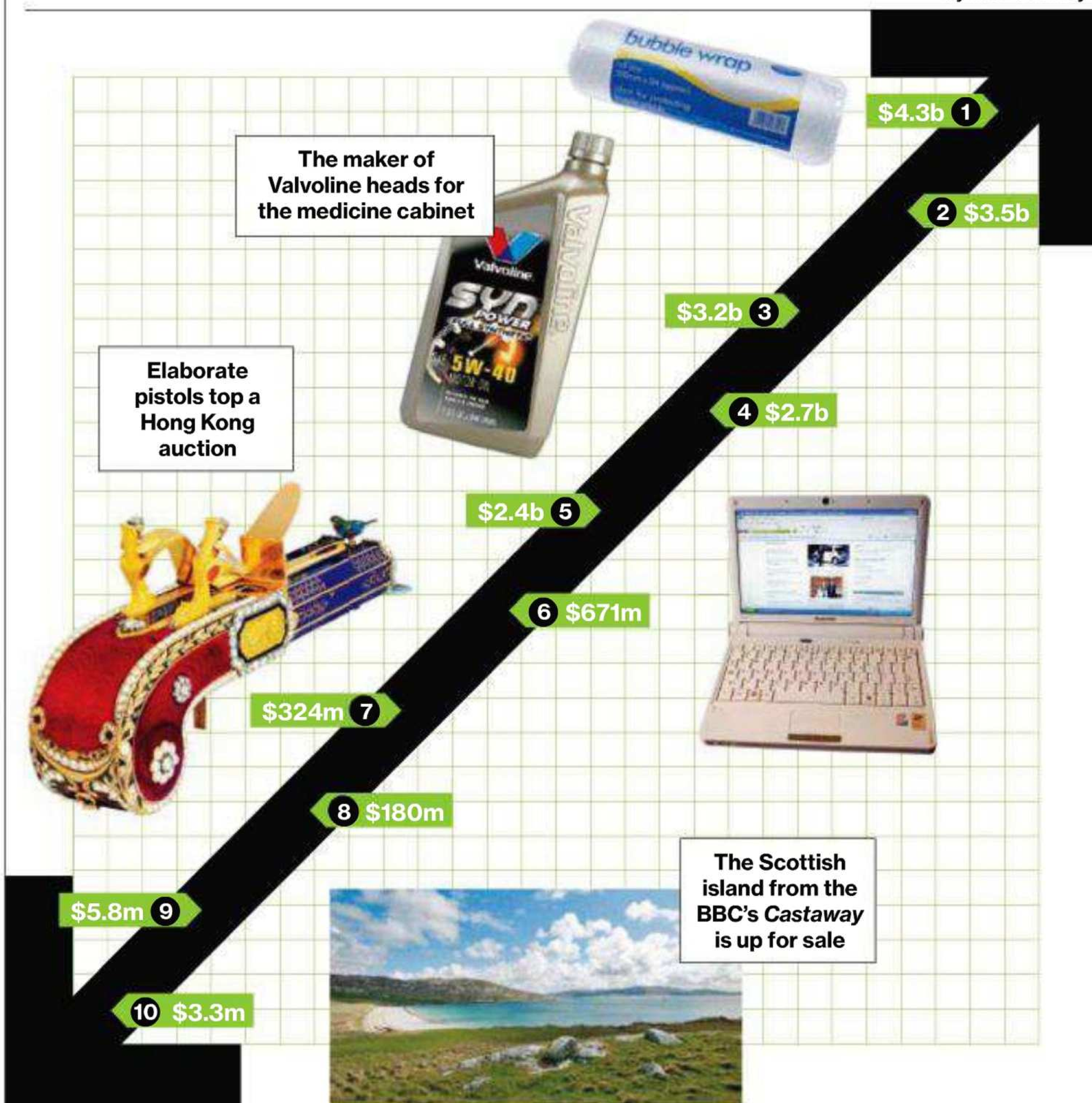
Harry Minter, 27, left his job at hedge fund **Headstart Advisers** in London in 2010 to manage the Guludo Beach Lodge in Mozambique after discovering the job posted on Escape the City. Last year Will Tindall, 28, found a job as chief communications officer of **Asia Pacific Investment Partners**, which invests in companies in Mongolia. He works out of Ulan Bator, Hong Kong, and London. The company hired a chief operating officer through the site this year and is advertising for a chief financial officer.

To lead their U.S. operation, Symington and Jackman are dispatching former **Merrill Lynch** money manager Mike Howe, 26. The Englishman lived in New York as a child. “The American way of thinking is very entrepreneurial,” he says, “so I think the upside could be huge.” B —*Simon Clark*

The bottom line *More than 30,000 people have signed up to scan exotic employment opportunities on Escape the City, coming soon to the U.S.*

Bid & Ask

by Ira Boudway



1 **Sealed Air**, the maker of Bubble Wrap packaging, agreed to buy cleaning products supplier Diversey Holdings for $4.3 billion.

2 Houston-based **Marathon Oil** gains leases on 141,00 acres of Texas oil and gas fields with the $3.5 billion purchase of Hilcorp Resources, a venture backed by private equity firm KKR.

3 **Ashland**, the maker of Valvoline motor oil, agreed to pay $3.2 billion for International Specialty Products, which makes ingredients used in shampoo, pharmaceuticals, and toothpaste.

4 **Intact Financial**, Canada's largest property and casualty insurer, is buying French insurer AXA's Canadian business for $2.7 billion.

5 South African antitrust authorities approved **Wal-Mart's** $2.4 billion offer for a controlling stake in wholesaler Massmart Holdings on the condition that no jobs are cut for two years.

6 In its biggest deal since acquiring IBM's PC business more than six years ago, China's **Lenovo Group** is offering $671 million for German electronics manufacturer Medion.

7 **Jones Lang LaSalle** will become the largest real estate broker in the U.K. with the $324 million purchase of London-based firm King Sturge.

8 Boston-based private equity firm **Thomas H. Lee Partners** is buying a minority stake in First BanCorp for $180 million. The Puerto Rico-based bank, a TARP participant, is selling shares to meet capital requirements.

9 A pair of singing-bird pistols made of gold and inlaid with diamonds and pearls sold for $5.8 million at a **Christie's** auction in Hong Kong.

10 **Taransay**, the uninhabited, 3,474-acre Scottish island featured in the BBC reality series *Castaway 2000*, is for sale at an asking price of $3.3 million.

CLOCKWISE FROM TOP: STUDIOMODE/ALAMY; ETHAN MILLER/GETTY IMAGES; CKD GALBRAITH; CHRISTIES

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ELOP'S



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FABLE



Market share dwindling, stock cratering, persistent takeover talk. How Stephen Elop is trying to lead Nokia past its epic fail. By Peter Burrows Photograph by Antonin Kratochvil

On a slushy morning in early March, Stephen Elop, a Canadian executive who built his résumé at U.S. technology companies, found himself in front of 2,000 Finns delivering a speech about failure. Six months earlier, Elop had been hired away from Microsoft, where he oversaw the company's Office products, to lead Nokia, the world's largest manufacturer of mobile phones. At its peak, in 2002, it contributed 21 percent of all of Finland's corporate tax revenue, and its success over the past dozen years has fueled the nation's sense of possibility in the same way that General Motors once propelled the aspirations of the U.S. Elop's message to his employees in the factory town of Salo was that, despite the 450 million phones the company sold in 2010—402 million more than Apple—almost everything Nokia had done since 2007 was wrong.

Without slides or props, Elop stood in the town's gymnasium and explained his signature decision as chief executive officer: to dump Nokia's homemade Symbian software, which has shipped on some 400 million phones, in favor of Microsoft's nine-month-old Windows Phone 7 software that runs on a mere 4 million. Elop spoke in his usual manner, an engineer's earnest, you-know-as-well-as-I-do appeal to reason. As he marched through his logic, the Nokia employees, aware that their new boss had only recently arrived from the very company whose software they would now be humiliatingly forced to use, betrayed no signs of emotion. Rather, a heavy silence filled the room, as if Elop were a defense attorney being watched for signs of inconsistency.

Much of what Elop had to say wasn't news to his audience, but it was still distressing. In his measured telling, Apple and Google had changed the industry from handset-focused to software-focused. Symbian had fallen too far behind to have any hope of catching up. Worse, the

Elop at Nokia's Espoo (Finland) headquarters on Apr. 12

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company's great hope for the future—a software platform created with chipmaker Intel, called MeeGo—wasn't ready to pick up the slack. He tried to negotiate a deal with Google to run Android, but Google refused to give the world's biggest phonemaker any advantages over its smaller partners, meaning Nokia's corps of 11,600 engineers would have next to no ability to add their own innovations to Google's software. "It just didn't feel right," Elop says to the crowd. "We'd be just another company distributing Android. That's not Nokia! We need to fight!"

Silence.

For a moment, Elop, 47, lays into the complacency he sees settling over the company. When he asks how many people in the crowd use an iPhone or Android device, few hands go up. "That upsets me—not because some of you are using iPhones, but because only a small number of people are using iPhones. I'd rather people have the intellectual curiosity to understand what we're up against."

Finally, after emphasizing that he believes mismanagement—not a lack of innovation—is what ails the company, Elop gets personal. "I'm deeply apologetic that I can't give you every bit of information about how this will impact each of you. That really sucks," he says of the layoffs destined to hit Salo's employees as a result of abandoning Symbian and MeeGo. "But my commitment to you is that we will get through this as quickly and transparently as we can. And I think we're going to make the best choices for the future." Within minutes the crowd has dispersed and headed back down the snowy road to the Nokia factory that since 1928 has been cranking out radios, TVs, and, more recently, cell phones. By Finnish standards, it could have gone worse. "It wasn't exactly a standing ovation, but people didn't walk out feeling resentful," says Ram Kuppuswamy, the plant's manager. "The disappointment doesn't go away. But this helped."

Pride can kill a company. So can bad management. Nokia suffered from both—and terrible timing, too. Four years ago it was the undisputed king of cell phones. Now its share of the smartphone market has plummeted from 49 percent, prior to the 2007 introduction of the iPhone, to 25 percent in the first quarter of 2011, according to Gartner Group. It's still the largest maker of simpler, nonsmart phones—it sells a million a day, many of them in China and India—but the company is already getting hurt by a throng of lower-cost Asian rivals. Sensing a giant on the ropes, recruiters from Intel and Google have set up shop in Helsinki hotel rooms, hoping to poach Nokia's top technologists. Thus far there haven't been mass defections, a testament to the value of national pride and extensive benefits. "Something is holding people there," says Benoit Schillings, a former Nokia executive who is now chief technology officer of mobile software maker Myriad Group. "These are extremely dedicated people, but there's a limit."

Each day, Nokia draws closer to that limit. While it delivered a surprisingly strong quarter ending Apr. 21, Elop announced dismal news on May 31: The company's sales and profits for the second quarter of 2011 will come in "substantially" below expectations, due to ferocious pricing pressure in Asia, Android, and mismanagement in China. The outlook is so dismal that Nokia disavowed its forecasts for the rest of the year.

If Elop had won any ground with Nokia's disillusioned investors since arriving, he lost it with this news. The stock plunged 19 percent, to $6.70, despite the fact that it was already selling at a 13-year low (shares fell 14 percent the day the Microsoft deal was announced). In the last four years, Nokia has shed 75 percent of its market value, leading to widespread speculation that it might be a takeover target. On June 1, a rumor started by a blogger had Microsoft buying the company for $19 billion. Elop calls the rumor "baseless." Asked if he had ever discussed an acquisition with Microsoft, he replies, simply, "Nope."

Amid the negative press and sudden rumors, Elop was, as usual, measured. "When you go through a transition like this," he says, "there are going to be bumps in the road." Investors, he notes, hate uncertainty, "and we've entered a period of uncertainty." "Bumps" and "uncertainty" understate it, but Elop insists he knew things would get worse before they got better. He remains committed, he says, to his process, and especially to the "management journey" he undertook to get Nokia back on track. From September 2010 through January, he shifted between 10-hour-a-day sessions with his team and more than 57 international trips to meet with phone carriers, suppliers, and others to craft a strategy they might support.

Despite his attempts to overcommunicate, however, Elop says his software deal with Microsoft was misconstrued as a Hail Mary to the receiver with the worst hands in the business. Microsoft had just 4 percent of the overall market prior to the Nokia deal. What Nokia didn't gain in market share, however, it hopes to gain in flexibility. The contract grants Nokia the right to stuff almost any innovation it can muster into its Windows Phones. Combine that with world-class hardware design and a strong distribution network, and, says Elop, "I'm as optimistic as ever." He adds: "I've got a working Windows Phone in my pocket now, and it's been less than three months since we began working with Microsoft. We're moving at a speed that's faster than Nokia has ever moved before."

Windows-based smartphones are the first stage of Elop's three-part comeback plan. One huge incentive for dumping Symbian was to cut the company's bloated costs. With an estimated $1.4 billion annual savings from discontinuing Symbian, he says he will invest more to protect and build Nokia's massive low-end phone business in emerging and yet-to-emerge nations in Asia and Africa, which brought in 33 percent of Nokia's sales in 2010. Reinvesting in emerging markets is Part Two. "If you live in the U.S., you can't really understand their power," says Paul Jacobs, CEO of chipmaker Qualcomm, whose technology is used in all Windows Phones. "They're going to be a great partner."

Elop's third priority has been dubbed New Disruptions. It's a fully sanctioned skunkworks, with teams in Helsinki and Silicon Valley, staffed by top technical talent from the discontinued Symbian and MeeGo efforts, especially MeeGo. That initiative began when Nokia hired a crew of inventive open source evangelists in 2009 with orders to dream up entirely new devices. A few months later they were reassigned to develop a replacement for Symbian. The goal, as Elop told a group of engineers in Berlin on Feb. 29, is once again to "find that next big thing that blows away Apple, Android, and everything we're doing with Microsoft right now and makes it irrelevant—all of it. So go for it, without having to worry about saving Nokia's

The History of Nokia

1865
Fredrik Idestam starts Nokia Ab, a paper mill.



1898
Rubber bootmaker Finnish Rubber Works founded.

1912
Finnish Cable Works founded; manufactures electrical cables.



1967
The paper, rubber, and cable companies form Nokia.

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On Feb. 11, Elop and Microsoft CEO Steve Ballmer announced their software partnership

SIMON DAWSON/BLOOMBERG

rear end in the next 12 months. I've taken off the handcuffs."

Recent history has hardened employees to the opportunities of a new era. "Under OPK, you could work on something for four years" before a decision was made to halt it, says Tuomas Artman, a former employee and Nokia contractor. OPK is Olli-Pekka Kallasvuo, the former CEO frequently accused by ex-Nokians of running a politicized, indecisive organization. Kallasvuo did not reply to a request for comment.

On his visit to Salo, Elop was shown a hi-fi speaker that encloses a phone, giving a richer sound. Another engineer handed him a phone and asked him to toss it into a tank of water. When the engineer dialed its number, the device, still submerged, rang. A nanoscale coating makes electronic parts water-resistant. "This kind of stuff has been sitting around people's desks, because it's too hard to get anything done around here," Elop says. "If we can get some of this to market—that's what gives me confidence."

Nokia's initial reaction to the iPhone is the most embarrassing example of what went wrong. When Steve Jobs unveiled the device in January 2007, "it was widely disregarded," says former manager Dave Grannan, who now runs Burlington (Mass.)-based voice recognition company Vlingo. "The attitude was that we'd tried touchscreens before, and people didn't like them." It had no multimedia messaging (MMS) capability. The reception and sound quality were poor. It couldn't be used with one hand. There was nothing to fear.

As iPhone sales took off, Nokia remained strangely detached, say a dozen current and former executives. The company didn't sit still, exactly. It opened its own app store, Ovi—but never put marketing muscle behind it. With no runaway hit like the iPhone, app developers largely ignored it. When Elop euthanized the Ovi brand name on May 16, it had 50,000 apps; Apple had 500,000. "It was an ignorant complacency, not an arrogant complacency," says Nokia human resources head Juha Akras.

Whichever variety, complacency was rampant, and it left Nokia particularly vulnerable to Android. While Apple cleaned up the high end of the market, Google flooded the low and middle by giving away its sophisticated software to all of Nokia's handset rivals. Nokia executives seemed content trumpeting their success selling marginally profitable low-end phones in Asia, until Android's smartphone share flew from 4 percent to 23 percent in 2010. Says Elop: "It's often hard to see a challenger when you're dominant, but what happened with Android was faster than anything we've ever seen."

Most of these problems could be traced back to Symbian. Never beloved by users, it became hopelessly buggy as Nokia tried to make the 10-year-old dog pull off iPhone-like tricks. Until last month, the company hadn't delivered a single new smartphone on time or without major software glitches since 2009, in part because of delays as scores of different hardware teams lobbied to get their pet capability—a new camera, say—built into Symbian. And while Apple and Google focus on making one operating system to power a wide variety of devices, software at Nokia had been seen as just one more "component" to enable hardware teams to craft their latest models. "The terminology shows the mindset," says Mark Wilcox, a former Nokia engineer. "The focus was on the phone, because Nokia had this amazing factory that could crank out 100 million units a year if you a got a hit." And while Apple and Google have created software tools that help outside developers to easily create apps, Nokia's equivalent tools gave developers fits. "Developing for Symbian," says Artman, the former Nokian, "could make you want to slice your wrists."

Software expertise was the main reason Stephen Elop made the list of candidates to become CEO of Nokia. According to Chairman Jorma Ollila, the board initially was leaning toward replacing OPK, a lawyer by training, with an internal candidate. By spring 2010, though, Symbian had been identified as the principal cause of Nokia's woes. "We needed some awesome, strong leadership" from the outside, says Ollila.

Over breakfast at a Redmond hotel last June, Ollila was quickly impressed with Elop's experience and biography. As head of Microsoft's $19 billion Office business, Elop had run one of the world's largest, most profitable software units. That included the successful launch of the latest version of its flagship Office suite, which was the first to include free scaled-down, Web-only versions of programs such as Word and PowerPoint. Elop developed a reputation for embracing challenges and resolving internal conflicts. While attending Canada's

1982
Nokia installs its first digital telephone switch, the DX200.

1987
Nokia launches the Mobira Cityman, its first non-bulky mobile phone.

1988
Sells rubber tire business. Shoes go in 1990.

1991
First-ever GSM call made using Nokia equipment.

McMaster University, he graduated second in his class, also finding time to help lay 22 kilometers of Ethernet Cable around campus to create one of the first Internet networks in the country. He worked so many hours that he would roll down the windows on the way home and sing the national anthem to keep from falling asleep at the wheel.

After a six-year stint as CIO of Boston Chicken from 1992 to 1998, Elop became CEO of Internet company Macromedia and brokered its $3.4 billion acquisition by Adobe in 2005. He then joined router maker Juniper Networks as chief operating officer, buoyed by assurances that he would soon replace CEO Scott Kriens. Days before he was to be named CEO (the press release had already been written), Steve Ballmer called to recruit him to Microsoft. Elop's choice to accept and leave Juniper in the lurch was "the hardest decision I've ever had to make." By comparison, joining Nokia, Elop says, was simple, despite the move to Helsinki and time away from his wife and five kids, including triplets, who live outside Seattle.

Having run a well-oiled machine, he hungered for a turnaround. He says he even demurred when Hewlett-Packard sent out feelers about replacing Mark Hurd in mid-2010. "He jumped head over heels for the Nokia job because he can help create one of the most important companies in the world," says Steve Miles, a CEO coach with the headhunter firm Heidrick & Struggles who has worked with Elop for years. "And he's willing to go into the smelly end of the trench to do it."

On Sept. 21, his first day, Elop sent an e-mail to every employee asking what they thought he should change, what should be left alone, and what they feared he wouldn't understand. There were more than 2,000 responses, mostly about accountability. (One of Elop's favorites: "At Nokia, everybody and nobody is accountable for nothing.") Elop personally responded to each one, and word got around that the new boss was serious about addressing their concerns.

He was not all sunshine, though. In one of his first meetings with employees, Elop recalls, he complained that there were different keystrokes required to mark an e-mail unread on the various Nokia phones he used. When an engineer in the crowd stood up and said Elop was wrong, the CEO invited him on stage to prove it. After some tapping, the engineer sheepishly backed off. "You're right," he admitted.

Three weeks after arriving, Elop launched a sweeping review of the company, code-named Sea Eagle. Day after day the executives would self-flagellate and sigh deeply. "Stephen forced us to look in the mirror and to really be real about what had happened," says human resources head Akras. Visitors to Finland are often warned to expect long silences, as people think through what they want to say, or if they want to say anything at all. This, at least, Elop has solved. "If you don't raise your hand, he'll say 'Hey, you didn't say anything,'" says Chief Financial Officer Timo Ihamuotila. Mary McDowell, a former Compaq executive who runs the low-end phone business, adds: "I've heard my colleagues speak more in the last four months than in the last 10 years."

From the start of his tenure, Elop hedged Nokia's bets on Symbian in case it proved unfixable. When technology analyst Tim O'Reilly offered to broker a meeting with Google's Eric Schmidt, Elop flew to Silicon Valley to let him know Nokia might have big decisions to make. Ballmer agreed to preliminary talks, too. In November, Elop and three lieutenants waited for a limo at the Bellevue Hotel near Microsoft headquarters when a super-extended prom-mobile showed up instead of a taxi. "I wanted to get out and walk the last block," says Elop.

If it was odd asking for a visitor badge at the same building he'd recently worked in, the déjà vu would only get more intense. Two years before, Elop led negotiations with Nokia over many of the same topics, but from the Microsoft side. Back then, Microsoft was trying to get Nokia to make a line of phones using Windows Mobile, and in return would make a version of Office to run on Symbian devices. Nokia wanted more; it asked Microsoft to use its Navteq mapping service and share revenues on ads that would appear with the maps. Unable to get the larger deal, the companies announced one to get Office onto some of Nokia's Symbian models.

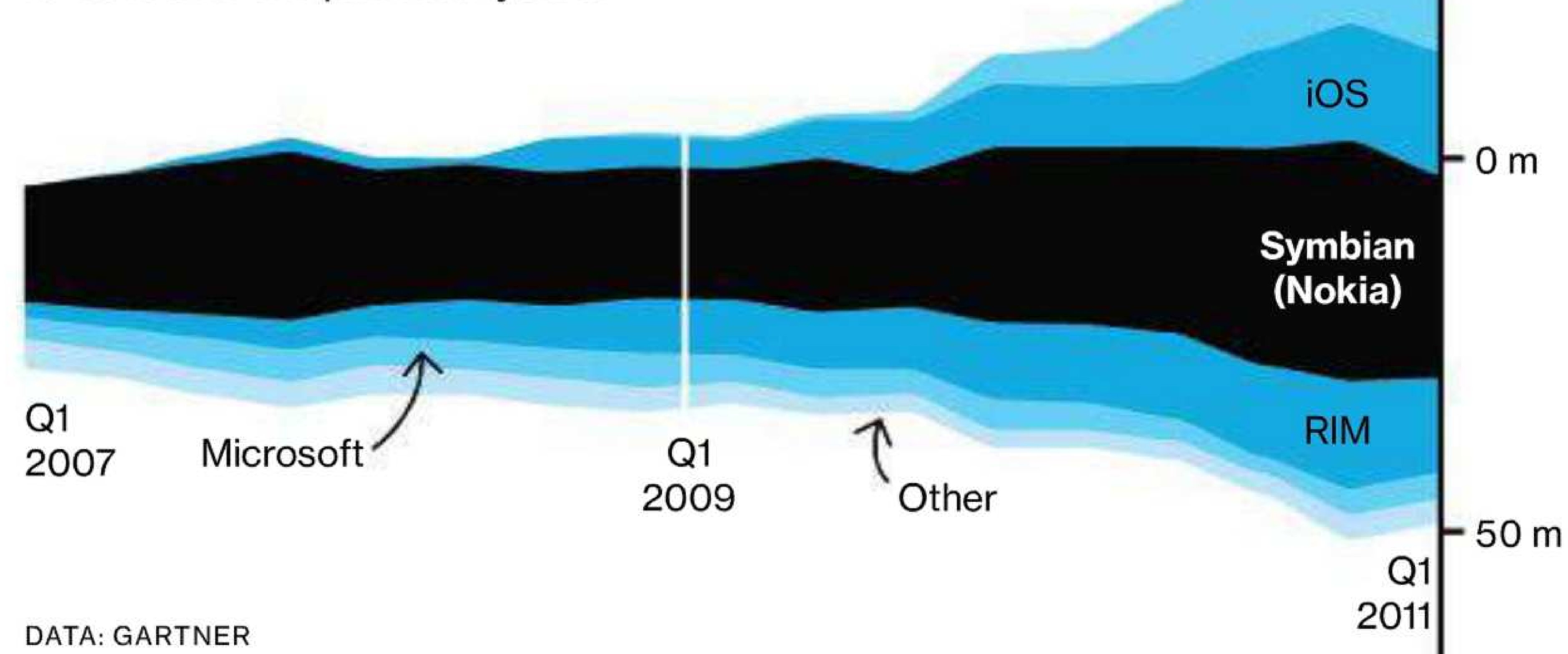
In a small conference room, Elop and three colleagues met with Ballmer, Internet services chief Qi Lu, mobile unit president Andy Lees, and head of Windows Phone engineering Terry Myerson. After some ribbing about being back at Microsoft, Elop stated the case simply: Nokia would either decide to stay with its own software or partner with Android or Microsoft, but it wouldn't delay. "I'm going to announce the decision at the analyst meeting in early February," he said. Sticking with MeeGo would avoid the need for a massive strategic and cultural shock, but going with the best offer could help Nokia's bottom line and gain it a fresh start in smartphones. "It was classic Stephen," says Myerson, who worked for Elop at Microsoft. "His superpower isn't his great intuitive judgment. It's his amazing ability to create a transparent, fast process that reasonable people can feel good about."

In Finland, unbeknownst to Microsoft, Nokia's bargaining power was diminishing. On Jan. 3, Chief Development Officer Kai Oistämö walked over to his boss's tiny cubicle to share his concerns about the MeeGo software that was supposed to be Nokia's answer to Apple and Android. The pair decided to quietly interview two dozen influential employees about MeeGo, from executives to rank-and-file engineers.

Before the first interview, Elop drew out what he knew about the plans for MeeGo on a whiteboard, with a different color marker for the products being developed, their target date for introduction, and the current levels of bugs in each product. Soon the whiteboard was filled with color, and the news was not good: At its current pace, Nokia was on track to introduce only three MeeGo-driven models before 2014—

The Last King of Finland: Smartphone Sales by Operating System

Nokia has suffered as Google and Apple bleed it of customers; market share has fallen from 64% to 36% over the past four years.



Nokia Stock Price

$60

$30

1997 Nokia reports the highest profits to date in the company's history.

1999 Nokia introduces the world's first WAP mobile phone.

2001 Sales nearly quintuple from five years before, reaching €31 billion.

2003 Launches the N-Gage, an ill-fated gaming device.

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far too slow to keep the company in the game. Elop tried to call Oistämö, but his phone battery was dead. "He must have been trying an Android phone that day," says Elop. When they finally spoke late on Jan. 4, "It was truly an oh-s--t moment—and really, really painful to realize where we were," says Oistämö. Months later, Oistämö still struggles to hold back tears. "MeeGo had been the collective hope of the company," he says, "and we'd come to the conclusion that the emperor had no clothes. It's not a nice thing."

Without an internal platform to stand on, Elop would need to choose between Android and Microsoft. (Apple and Research in Motion make their own hardware and software and were out of the question.) Wall Street was expecting to hear his plan to save Nokia at an event for stock analysts in London on Feb. 11.

The obvious choice would have been to jump on the Android bandwagon. Attracted by Google's free software, every other major smartphone maker except Apple and RIM had already done so, and almost every large carrier was supporting Android as the only genuine Apple alternative. But Google was riding so high that it essentially refused to negotiate, offering no concessions to Nokia despite its global presence. Elop later told the Salo employees that Google "acted like they'd already won. Apple and Android deserve some real competition."

That left Microsoft. Its Windows Phone 7 software is well regarded by technorati ("It's new, it's fresh, it stands out," says Gartner Group analyst Roberta Cozza), but very few people are buying Windows 7 Phones. Elop was certain, too, that he'd be accused of being a double agent for his former company.

With the clock ticking on the London analyst meeting, talks with Microsoft went into high gear. On Jan. 10, Oistämö and a few colleagues spent the morning negotiating in a windowless room in the basement of a London hotel. To that point, Microsoft had forced handset makers to obey strict rules about how they could customize Windows Phone 7, and they wanted the same from Nokia. Not only did Nokia respond that it wanted the right to innovate freely, it asked Microsoft to commit to using Nokia technology as a foundation of the Windows Phone platform, particularly its detailed Navteq maps database. Believing that Microsoft could not afford to let the largest phonemaker in the world throw its weight behind Android, Oistämö also asked for a large payment.

The sides reconvened that night for Indian food, and the deal was done in principle by dessert. "We got a deal that was completely different from anything they'd ever done before, and it's because we promised to do our best work for Windows Mobile 7," says Elop. He won't spell out financial terms but says there's a net benefit in the billions. Asked if the payment amounts to a high-tech shakedown, he smiles widely. "We call them marketing funds."

On Feb. 3, Elop gave employees as big a hint as he could of the announcement to come, without breaking disclosure laws. Standing in the wood-and-glass atrium at Nokia's headquarters in the Helsinki suburb of Espoo, hundreds of employees lined each of the eight floors to listen as Elop compared Nokia to a worker on a burning oil platform. He said the only choice for the worker was to do what would otherwise be unthinkable: leap into the frigid North Atlantic. In the story, the worker survived, but Elop warned: "Nokia, your platform is burning."

Elop "can help create one of the most important companies in the world. And he's willing to go into the smelly end of the trench to do it"

Ten days after confirming Nokia's epic fail, Stephen Elop is out selling the deal to employees. His first stop is the research and development facility in Tampere, the town that houses most of the MeeGo engineers—many of whom left early as a sign of protest on the day the Microsoft deal was announced. After apologizing for the effect layoffs will have on many—Nokia announced on Apr. 28 that it would lay off 4,000 people by the end of 2012 and transfer 3,000 to Accenture, which will handle Symbian updates for existing models—Elop implores the attendees to wait before meeting with recruiters from Apple or Google. "Who wants to help build the iconic Windows Phone? Who wants to contribute to the next big disruption? Are you in or are you not? I need to hear from you."

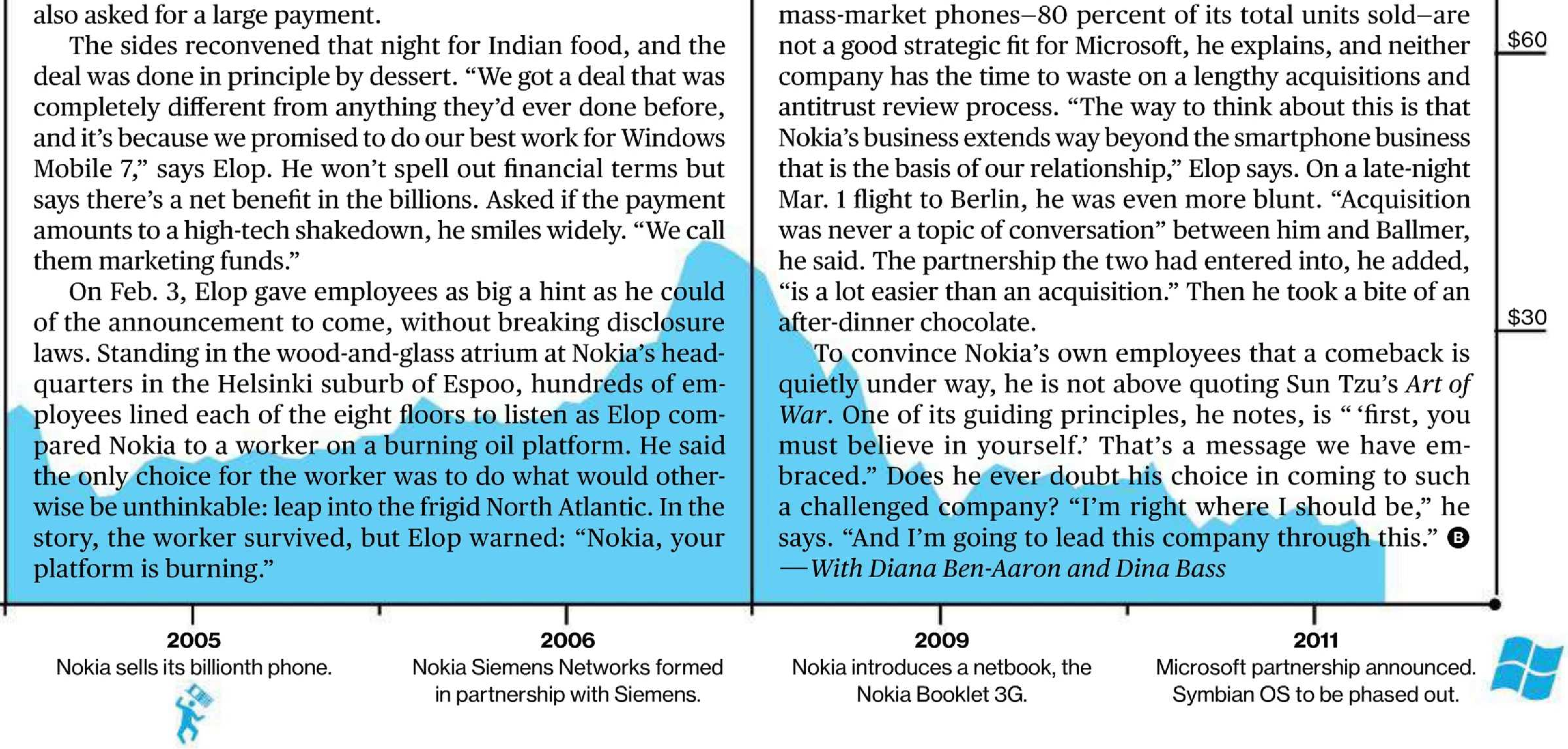
Given Nokia's troubles this quarter, many analysts expect its woes to get much worse in the near term. Sales of Symbian phones are falling faster than expected, but it will take more than a year to bring out a full line of Windows-based phones to compensate. Gleacher & Co. analyst Stephen Patel expects Nokia's smartphone share, at 27 percent now, to hit 14 percent in 2012. That assumes the Microsoft partnership doesn't turn into a disaster, as tech partnerships sometimes do. "The road ahead is going to be very challenging," says Patel, who predicts Nokia will be smaller and less profitable.

Yet the view inside tech circles on Elop's big call has improved as the shock wears off. Carriers unhappy at choosing between being pushed around by Apple or Google are quietly pulling for Nokia. The Gartner Group even believes Windows Phones will hit 19.5 percent market share in 2015—ahead of Apple.

Elop denies that Nokia's Windows-based phones set the stage for selling the company to Microsoft outright. Nokia's mass-market phones—80 percent of its total units sold—are not a good strategic fit for Microsoft, he explains, and neither company has the time to waste on a lengthy acquisitions and antitrust review process. "The way to think about this is that Nokia's business extends way beyond the smartphone business that is the basis of our relationship," Elop says. On a late-night Mar. 1 flight to Berlin, he was even more blunt. "Acquisition was never a topic of conversation" between him and Ballmer, he said. The partnership the two had entered into, he added, "is a lot easier than an acquisition." Then he took a bite of an after-dinner chocolate.

To convince Nokia's own employees that a comeback is quietly under way, he is not above quoting Sun Tzu's *Art of War*. One of its guiding principles, he notes, is " 'first, you must believe in yourself.' That's a message we have embraced." Does he ever doubt his choice in coming to such a challenged company? "I'm right where I should be," he says. "And I'm going to lead this company through this." B

—With Diana Ben-Aaron and Dina Bass



DATA: BLOOMBERG, NOKIA, NEWS SOURCES



Not Just the

"The Martyrs of the Revolution" in the pages of *Al-Masry*

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Egypt's largest independent newspaper, *Al-Masry Al-Youm*, is showing Egyptians what a free press looks like. More than social media, that may be the key to the nation's future.
By Romesh Ratnesar

Facebook Revolution

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"We prayed the revolution would succeed,"

says Magdy El Galad, the editor-in-chief of *Al-Masry Al-Youm*, the largest independent newspaper in Egypt. "Because if it failed, we would have been assassinated." A wry smile crosses his face. He's joking, sort of.

It's Saturday afternoon, a working day in Cairo, and El Galad—who is 47 and reed-thin, with a sallow countenance and jet-black mustache that make him look a little like the old *Saturday Night Live* character Father Guido Sarducci—is seated at a table in his dimly lit office, sipping tea. He keeps three cell phones and a pack of cigarettes close at hand as he marks up pages about to go to press. The early edition of the Sunday paper goes on sale at 9 p.m., and El Galad has a little more than two hours to decide what to put on the front page.

He became the editor of *Al-Masry Al-Youm* (which translates to "The Daily Egyptian") in 2005, the year after it started publishing. Since then the paper's circulation has jumped from 10,000 to over 500,000, more than double the largest state-run newspaper, *Al-Ahram* ("Pyramids"), which means that what was once the scrappy voice of opposition is now Egypt's largest daily. During the anti-government revolt earlier this year, allies of the embattled president, Hosni Mubarak, vowed to shut down the paper after order was restored. It turned out that it was the Mubarak regime that got shut down, and *Al-Masry*'s early support for the revolution cemented its place as Egypt's most objective, important, and influential newspaper. It also placed the paper squarely in the middle of the ongoing struggle for the country's future. *Al-Masry Al-Youm* may not have figured out how to turn a profit publishing on newsprint, but it is showing Egyptian society something about what a free press looks like—and why the revolution's outcome hinges, in part, on preserving it.

One of El Galad's assistants hands him a cell phone. It's the Prime Minister, Essam Sharaf. El Galad grabs the nearest blank sheet of paper and starts scribbling. He had heard that Sharaf's upcoming trip to the Gulf was canceled; he asks about it during their five-minute interview. "The Prime Minister says that Saudi Arabia is an important stop for him. They're trying to work something out," El Galad says after he hangs up the phone. "We'll see what will happen in a couple hours." When Sharaf's office informs him that the trip is back on, *Al-Masry* touts the exclusive on the front page. This kind of access was unthinkable under Mubarak. "Because of the revolution," El Galad says, lighting another cigarette, "people in Egypt have realized the influence of the press."

The demonstrations that ended Mubarak's 30-year rule have become known as "The Facebook Revolution," but the uprising had old-media roots. Over the last decade, the emergence of independent media organizations like *Al-Masry Al-Youm* provided Egyptians with a picture of the corruption, venality, and fecklessness of the Mubarak regime. When pro-democracy activists began converging on Tahrir Square in January, millions of fed-up Egyptians were primed to join them. "The social media obviously played a very important role," says Khaled Fahmy, a professor of history at the American University in Cairo, "but the more traditional media played a vital role, too—maybe not in triggering the revolution but in preparing the way for it."

And yet four months later, the revolution's momentum has stalled and the press is again walking a delicate line—albeit one painted by a different authority. The comity that prevailed during the 18-day uprising has given way to spasms of violence on Cairo's streets. Leaders of the Tahrir Square revolution charge that the country's caretaker government, which is being run by the military until elections this fall, has been too lenient toward Mubarak, his sons, and their cronies. (Stung by the criticism, the military council announced on May 23 that Mubarak will be tried for the deaths of protestors.) With Egypt and much of the Middle East on the edge of political chaos, there's a growing possibility that conservative religious groups, such as the fundamentalist Muslim Brotherhood, may end up seizing power.

If that happens, the consequences for Egypt's nascent independent press could be dire. The media industry in Egypt is expected to grow to $1 billion in revenues by 2013, with newspaper advertising accounting for half of it, according to a 2010 study sponsored by the Dubai Press Club. Daily newspaper circulation in Egypt stands at more than 4.3 million, by far the highest in the Arab world.

Occupying the fourth floor of a high-rise building in Cairo's Garden City district, buzzing with youthful, nicotine-fueled energy, *Al-Masry Al-Youm* embodies the spirit of the idealized new Egypt. The newsroom is populated by more than 100 reporters and Web producers, many in their twenties, wearing jeans and collaborating freely with members of the opposite sex. Editors meet around a circular conference table in the middle of the scrum to emphasize the paper's commitment to transparency.

The two-week revolution was a professional crucible for *Al-Masry*'s young journalists. Clashes between protestors and the police raged so close to the paper's offices that reporters had to dodge rubber bullets and outrun tear gas. Editorial meetings were interrupted by the rattle of gunfire and explosions. As security deteriorated in Cairo, El Galad instructed female employees to stay home, so they wouldn't be on the streets at night. Many women opted instead to sleep in the office, as did virtually all of the paper's male staff.

The fact that a newspaper like *Al-Masry Al-Youm* existed to report on the revolution is almost as improbable as the event itself. *Al-Ahram*, Egypt's first daily newspaper, was founded in 1875, while Egypt was under British rule, and in the first half of the 20th century, it, along with other Egyptian press outlets, helped shape the middle class. But the revolution of 1952, which toppled the monarchy and catapulted Gamal Abdel Nasser to power, signaled the start of the Egyptian media's decline. Nasser nationalized the country's most prominent publications. Newspapers like *Al-Ahram* didn't exactly become mouthpieces of the state, but they were far from objective.

After Mubarak became President in 1981, state control of the media tightened. For the next two decades, nearly all Egyptian broadcast and print outlets were owned and controlled by the Mubarak

Clashes between protestors and police raged so close that reporters had to dodge rubber bullets and outrun tear gas

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government or the ruling National Democratic Party. State-run dailies, like *Al-Ahram* and *Al-Akhbar*, ballooned into public bureaucracies. Their top editors were appointed by the regime, and in return for favorable coverage of Mubarak and his family, they received massive subsidies to hire thousands of reporters, offset production costs, and maintain low newsstand prices—keeping potential private competitors out of the market.

In 2002, Salah Diab, the founder of an oil-and-gas conglomerate called Pico Energy and grandson of a newspaper publisher from the pre-Nasser era, decided to launch an independent daily. "The business proposition was simple," says Sherif Wadood, *Al-Masry Al-Youm*'s current chief executive officer. "There was no good paper in Egypt." Diab hired Hisham Kassem, a prominent publisher and intellectual, to run the paper, and convinced three other Egyptian executives to invest in it. Launched with $10 million, *Al-Masry Al-Youm*'s first edition hit the streets on June 7, 2004. "We had 50 editors and reporters working out of one room," says Alaa AlGhatrifi, now the paper's chief investigative editor. "We had to go outside and use public pay phones to call sources."

In Egypt's arid media landscape, *Al-Masry*'s oversized banner, large display photos, and color advertisements stood out. It covered long-neglected social issues like crime, pollution, and the status of women. In 2005, *Al-Masry* published a front-page article by Noha al-Zeini, a high-ranking female judge, calling the results of that fall's parliamentary elections—won overwhelmingly by Mubarak's party—a fraud. The article put *Al-Masry* on the cultural radar, and within two years the paper's readership had quintupled. It also spawned imitators.

Mubarak didn't allow the moment to last. State prosecutors twice detained El Galad for publishing articles deemed embarrassing to Mubarak and his allies. Investors behind *Al-Masry Al-Youm* found themselves cut out of government contracts. At one point the paper's owners rebuffed an attempt by Ahmed Ezz, a billionaire with close ties to Mubarak's son, Gamal, to buy a controlling stake in *Al-Masry*. A June 2010 Ministry of Information document, which was leaked after the revolution, detailed the government's plans to impose curbs on the media in the "coming period"—starting with the November 2010 parliamentary elections and continuing through the scheduled 2011 presidential vote, which most Egyptians believed would be rigged in favor of Gamal Mubarak. A columnist for one state-owned magazine reported that once Gamal became President, he would dismantle *Al-Masry Al-Youm* for good.



Al-Masry editor El Galad, seated center, oversees a newsroom of more than 100

In the fall of 2010, at a White House summit attended by the leaders of Egypt, Israel, Jordan, and the Palestinian Authority, photographers captured President Barack Obama walking toward a podium in the East Room, with the four others trailing behind him. *Al-Ahram* ran the photo on its front page—Photoshopped so that Mubarak appeared to be leading the procession. The episode made *Al-Ahram* the object of ridicule and revealed the lengths to which the regime would go to protect Mubarak's image.

In the last months of 2010, the President's men began to move further on the independent media, forcing unsympathetic TV hosts off the air, strong-arming newspaper editors to fire their best reporters, even seizing financial control of some pro-reform publications. The overthrow of Tunisia's longtime strongman, Zine el-Abedine Ben Ali, on Jan. 14, 2011, only heightened Mubarak's paranoia. *Al-Masry Al-Youm* braced for the crackdown to come.

On the morning of Jan. 25, more than 100,000 Egyptians converged on Tahrir Square in central Cairo, and thousands more poured onto the streets of Alexandria, Suez, and other cities across the country. That evening, the police responded with force.

Inside *Al-Masry*'s newsroom, less than a mile from the heart of the action, El Galad and his team debated how to handle the story, the biggest ever public demonstration against Mubarak's rule. Throughout the day the paper had posted eyewitness reports and videos of the scene in Tahrir on its website. "Our reporters were calling back and telling us this was different from anything they'd seen before," says El Galad. "There were completely different faces there, people who you would never have seen at demonstrations." That afternoon the head of the Ministry of Information called El Galad and warned him that the website's coverage of the protests might pose a threat to national security. He suggested the paper reconsider how it played things in its more influential print edition later that night.

El Galad wanted to mark the significance of the day's events without giving them a categorical endorsement. Ahmed Mahmoud, the art director, designed a front page with the top half taken up by a single aerial image of the crowd in Tahrir Square, illuminated by street lights. Above it was a two-word, sirenred headline: The Warning. "The thought that ran through my head was, newspapers are made in these moments," says *Al-Masry* CEO Wadood.

Hours after the Jan. 26 edition went on sale, people in Tahrir started grabbing copies of the front page and raising it above their heads. *Al-Masry Al-Youm*'s coverage was all the more conspicuous because on the same morning, *Al-Ahram*, the largest state-run daily, chose not to mention the protests at all.

On the afternoon of Jan. 26, El Galad received a call from the same minister who had admonished him the day before. "Since when does the President receive warnings from the media?" the minister demanded. He vowed that the protests would be crushed and that Mubarak would "punish the paper him-

OPENING SPREAD: HOLLY PICKETT/REDUX; THIS PAGE: PHOTOGRAPH BY KIM BADAWI FOR BLOOMBERG BUSINESSWEEK

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self." After that, "our contact with the regime was cut off entirely," El Galad says. "We decided we couldn't yield," he continues. "We thought we were fighting for the rights of the protestors, but we were actually fighting for ourselves."

On Jan. 28 the regime shut down local Internet and cell-phone service. Kismet El-Sayed, the head of *Al-Masry*'s digital operations, posed as a foreign guest and talked her way into a room at the Inter-Continental Cairo hotel, which still had a connection to a server outside the country. Twenty staffers moved in and managed the paper's website from there. That afternoon, an *Al-Masry* video reporter shot footage from the room of a crowd of thousands leaving Friday prayers and attempting to cross a bridge leading into Tahrir Square, only to be repulsed by government tanks outfitted with water cannons. After *Al-Masry* posted the footage on its website, it was picked up and replayed by foreign networks like CNN and BBC, which the Egyptian authorities had prevented from broadcasting live images of the protests. *Al-Masry* was also the first publication to run individual photos of protesters killed by the police. The "Martyrs of the Revolution" feature became an icon, as demonstrators in Tahrir Square started pinning the page to their T-shirts.

On Feb. 11, one day after Mubarak provoked more outrage by refusing to announce his resignation in an address to the nation, Egypt's military leadership finally intervened. At 6 p.m., Mubarak's deputy, Omar Suleiman, announced that the President had resigned. The front page of *Al-Masry Al-Youm*, published that night, featured an arc of head shots of the revolution's martyrs, framing the words, "I'm going to die so my country can live," a lyric from a famous Egyptian pop song. A glowing photo of the celebrations in Tahrir Square, fireworks exploding overhead, covered more than half the page. Beneath it was a two-word headline, again in red: The Beginning.

"The Warning," declared *Al-Masry*'s Jan. 26 edition; people in Tahrir Square held copies above their heads


المصري اليوم
انذار

Though happy to see Mubarak gone, many revolutionaries are suspicious of the Supreme Council of the Armed Forces, which assumed control on Feb. 11 and will run the country until a new government is elected. Activists say that since the revolution, scores of demonstrators have been mistreated by members of the army—in one instance, protestors were allegedly detained and tortured inside the Egyptian National Museum—but the media has refused to investigate those claims. "We've gone to journalists and shown them the evidence," says Hossam Bahgat, executive director of the Egyptian Initiative for Personal Rights. "The reporters file the stories, and then the editors kill them. We're not sure if it's self-censorship or if they're acting under instructions from the army."

I met Bahgat at an outdoor cafe near his office in Cairo, where he was drinking tea and smoking a hookah pipe. He shared a letter sent by General Ismail Etman, a member of the ruling military council, to all working journalists, warning them against publishing without the military's permission "any articles/news/press releases/complaints/advertising/pictures concerning the armed forces or the leadership of the armed forces." Bahgat sighed. "My concern is that [the media] is too willing to accept these kinds of orders," he said.

The editors at *Al-Masry Al-Youm* say that the army occupies a unique place in Egyptian society and is the "red line" that most journalists refuse to cross. That reticence has become more pronounced in the last three months, in part because many Egyptians view the military as the only line of defense against the rising prevalence of crime, sectarian violence, and religious extremism. "What I'd say to the people criticizing us is, give me an example of any media outlet that is publishing stories about the military council the way you would like," says Ehab Zalaky, *Al-Masry*'s managing editor. "You have different concerns when you're on the outside of the situation than you do when you're in the middle of it, like us."

The biggest concern of all may be the growing assertiveness of the Muslim Brotherhood, which has been strengthened by the failure of the revolutionaries to form a cohesive political movement. When I met El Galad in late April, his anxiety about the prospect of an Islamist takeover in Egypt was palpable. "If the Muslim Brotherhood succeeds in winning a lot of political power," he said, "they will be a big threat to freedom of the press in Egypt."

"If the Muslim Brotherhood succeeds," El Galad says, "they will be a big threat to freedom of the press in Egypt"

And yet it's hard to imagine the Egyptian media ever reverting to Potemkin, state-sponsored journalism. Egyptian readers simply won't stand for it. Perhaps the most enduring contribution of *Al-Masry Al-Youm* to Egyptian life has been to reestablish what qualifies as real news—and help make its competitors better in the process. In the last three months, the newsrooms at *Al-Ahram* and the other state-owned publications have undergone their own revolutions, turfing out the executives and editors who had allowed them to become extensions of the Mubarak regime. Yehia Ghanem, a longtime writer and editor at *Al-Ahram*, says, "The emergence of independent newspapers encouraged more people here to transgress forbidden ground. We owe that to them." And thanks to a recent easing of licensing restrictions, the country is in the midst of a publishing land rush, with at least a half-dozen new independent dailies preparing to launch by the end of the year.

Far more than its competitors, *Al-Masry* has expanded its presence on other platforms, creating a video-heavy, interactive website, an iPad app, and an online English-language edition whose reporting is often more aggressive than that of the newspaper itself. A weekly print version of the paper's English-language edition is set to launch this month, and Wadood has ambitions to develop a nightly television program featuring *Al-Masry*'s editors and reporters. Egypt's future is full of uncertainty, but as every savvy newsman knows, crises are also opportunities. "There's a lot of news in Egypt these days," Wadood says. *Al-Masry Al-Youm* still wants to make some of its own. B



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Rapid Rewards just got more rewarding. With better benefits, more rewards, and even faster free✈ flights! Enjoy unlimited reward seats. No blackout dates. And your points don't expire.*
New Members, sign up now to receive 250 Bonus Points at southwest.com/bizwk, or text TRAVEL and your e-mail address to RAPID (72743).
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BONUS POINTS!
Standard text messaging rates may apply. Offer is only valid for new-Member enrollment. ✈The Rapid Rewards reward flight is free, but travel is subject to the government-imposed September 11th Security Fee of up to $10 per roundtrip. Number of points required to redeem for free flights is dependent on fare availability, destination, and time and day of travel, which are subject to change. Travel good on Southwest Airlines published, scheduled service. *Points don't expire as long as you have flight or Partner earning activity every 24 months. All Rapid Rewards rules and regulations apply. ©2011 Southwest Airlines Co.

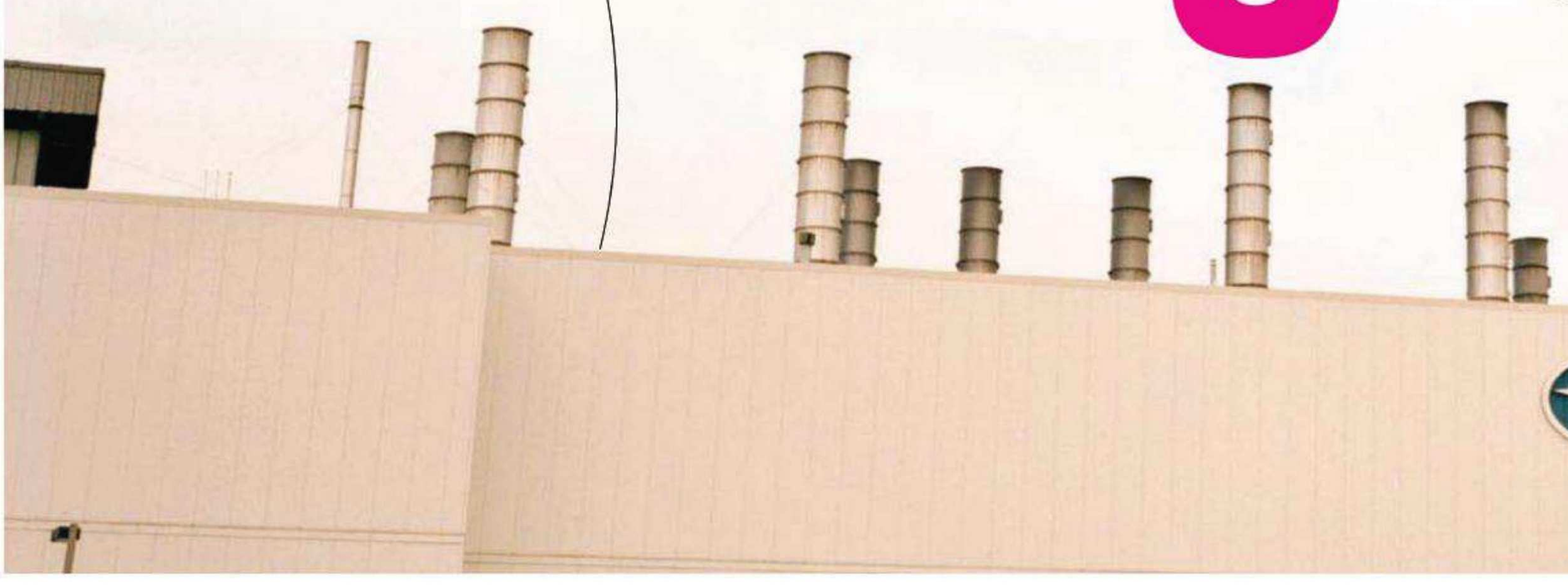
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0 LAYOFFS

The Scrappiest Car Manufacturer In America

0 WASTE

0 PAY CUTS



0 STRIKES

0 HEALTH-CARE PREMIUMS

By Roben Farzad

Photographs by Daniel Shea



Recognized by the Indiana Department of Environmental Management as "going above and beyond current regulations," Subaru of Indiana Automotive (SIA) works with the agency to expedite inspections and permitting

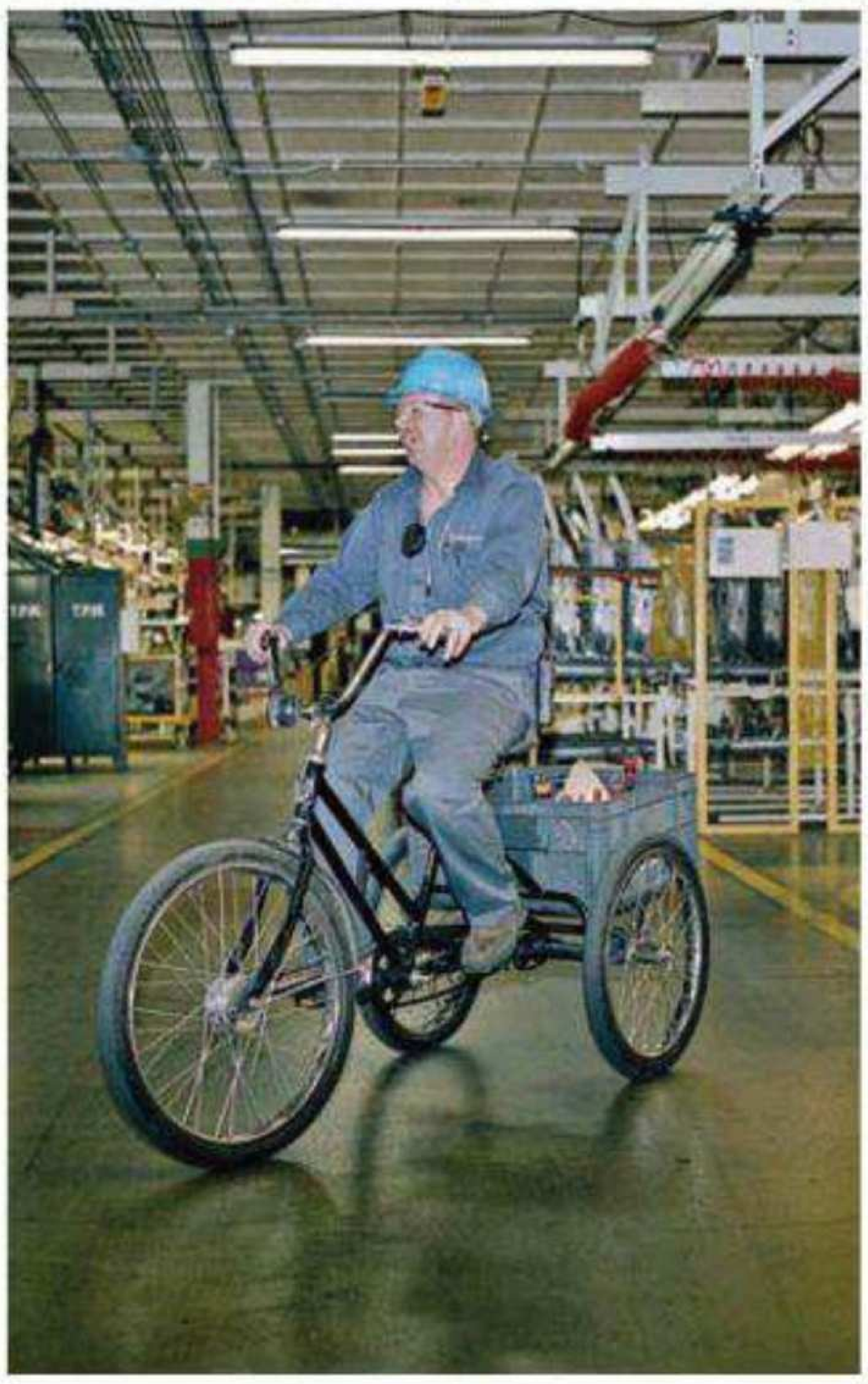
In 2010, SIA built 260,000 Subaru Outbacks, Legacies, Tribecas, and Toyota Camrys. Workers such as Joe Heath make green look easy (below)

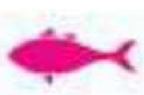


Set amid tawny popcorn and soy- bean fields, weathered barns, and rusty silos, the Subaru of Indiana Automotive plant cuts a swath. A 3.4-million-square-foot monolith abutted by railroad tracks, SIA has a mountain of compost and the occasional coyote skittering through the surrounding 832 acres of woodland. Step inside, though, and you'll discover why this might be the most exemplary car factory in America.

In its 22-year history—a period that has spanned three recessions, a global financial crisis, massive U.S. auto bankruptcies, and the departure of Isuzu, a founding partner, from the operation—SIA has rolled out more than 3 million vehicles and has never resorted to layoffs. Instead, it's given workers a wage increase every year of its operation. Staffers also enjoy premium-free health care, abundant overtime ($15,000 each, on average, in 2010), paid volunteer time, financial counseling, and the ability to earn a Purdue University degree on-site—all in a state that has lost 46,000 auto jobs and suffered multiple plant foreclosures in the past decade. And the truly astonishing thing is how it achieved all this: through a relentless focus on eliminating waste. "This is not about recycling, or a nice marketing to-do," says Dean Schroeder, a management professor at Valparaiso University who has studied the plant. "This is a strict dollars-and-cents, moneymaking-and-savings calculation that also drives better safety and quality."

Toyota made *kaizen*—the Japanese principle of constant "change for the better," with a special focus on efficiency, aka "pushing lean"—famous. SIA, you could say, has instilled green *kaizen*, or pushing green. Starting in 2002, the SIA set a five-year target for becoming the nation's first zero-landfill car factory. That meant recycling or composting 98 percent of the plant's



					
3	**22**	**6**	**$600,000**	**1.41**	**10-1**
American bald eagles on campus	Years Subaru has given wage increases	Ponds. One is stocked with fish for a Cub Scouts fishing derby	Savings from banning smoking since 1994	2010 OSHA incident rate per 100 associates, one of the lowest in the U.S.	Ratio of applicants to openings

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As the residents of Anaheim, California, walk their dogs in the morning, few realize there's a substation right under their feet distributing power throughout their neighborhood.

The station under Roosevelt Park delivers much-needed power to 25,000 people. It's the first underground substation in America, a feat made possible by an advanced design that makes it 70 percent smaller than traditional substations.

It seems like such a simple idea. But by putting the substation beneath the ground instead of above it, Siemens helped make life in Anaheim a little bit better.

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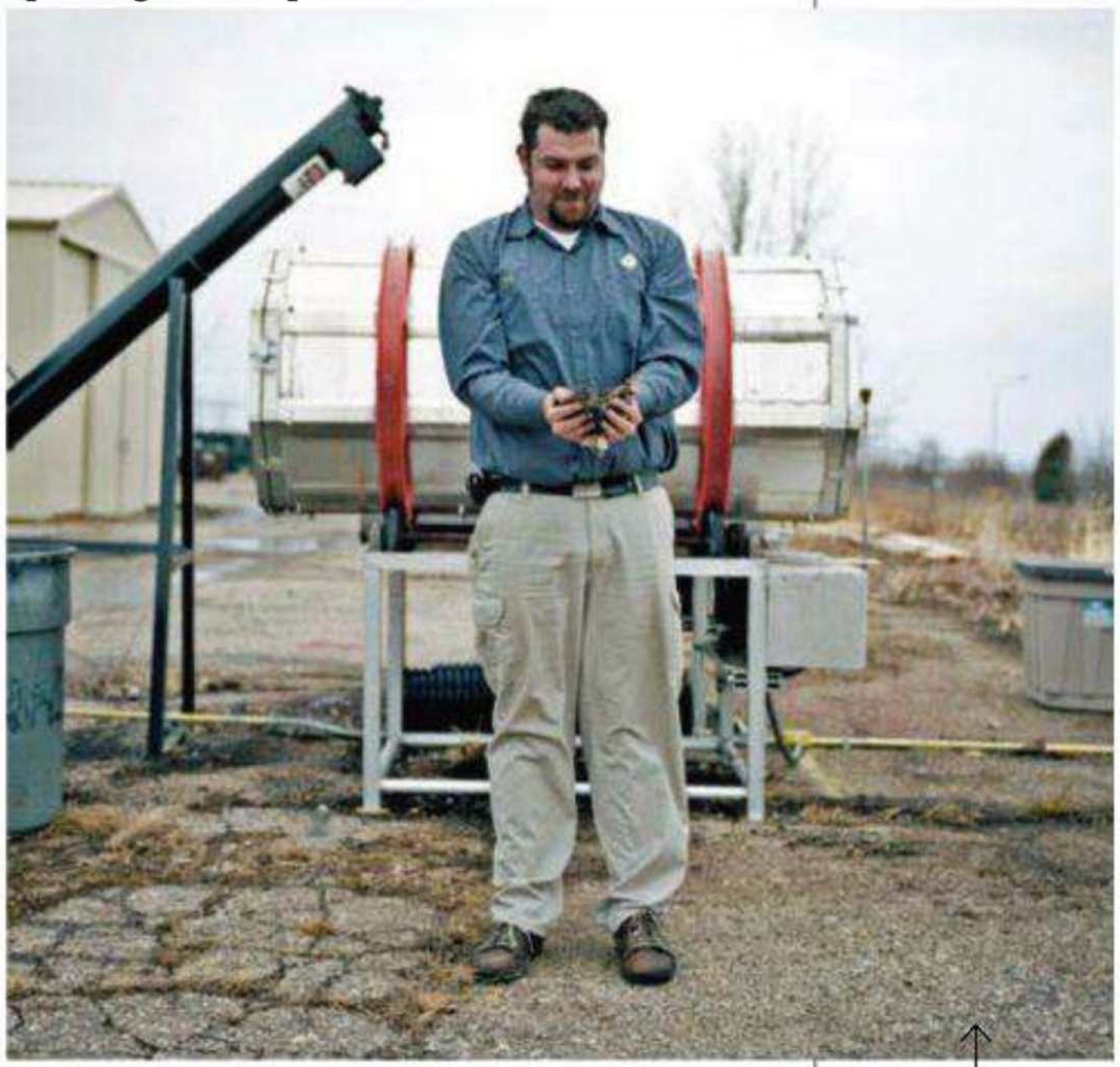
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waste—with an on-site broker taking bids for paper, plastic, glass, and metals—and incinerating the remaining 2 percent that isn't recoverable at a nearby waste-to-fuel operation to sell power back to the grid. Within two years, the results spoke for themselves.

"Everyone quickly saw the green dividend of not wasting anything," says Tom Easterday, the plant's executive vice-president, passing a stack of yellowed Styrofoam cases that have survived four round trips around the globe. "You reduce packaging, negotiate a better deal from suppliers, and everyone then shares in the savings."

Today, the plant abounds with boxes and containers scribbled over with marks that show how many times they have traveled from Japan to Indiana and back (and back again). On a tour of the plant, Easterday sped a golf cart past a welder whose metal



SIA's composter, overseen by Matt Green (above), churns out organic matter that's sold to farmers or given to workers

shavings are swept off the asphalt floors and auctioned into a roaring bull market for copper. Last year, Easterday says, SIA saved approximately $5.3 million by obsessively reducing, recycling, composting, and incinerating; Valparaiso's Schroeder calculates that Subaru saves multiples of that figure by using zero-landfill discipline to reduce worker injuries and fatigue. He cites the example of SIA's switch away from taking cars apart to check the quality of welds—a process that wasted metal and risked jackhammer injuries—to ultrasonic technology that did so better, faster, and far cheaper. SIA workers get bonuses (grand prize: a new Subaru Legacy) for pointing out excess packaging and processes that can be cut from the assembly line and then rebated by suppliers. All the savings are effectively plowed back into plant operations—and overtime.



Every process, body motion, and second of production is accounted for at SIA. For a visitor, one striking trick is the audio played by resupply robots—the theme from the movie *E.T.*, say—as they travel the factory floor. Production teams can identify robots by the tunes they play

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RECYCLABLES

↓

BRASS LUG NUTS
Before 2009, 33,000 pounds of lug nuts were thrown away each year. They've since been phased out altogether

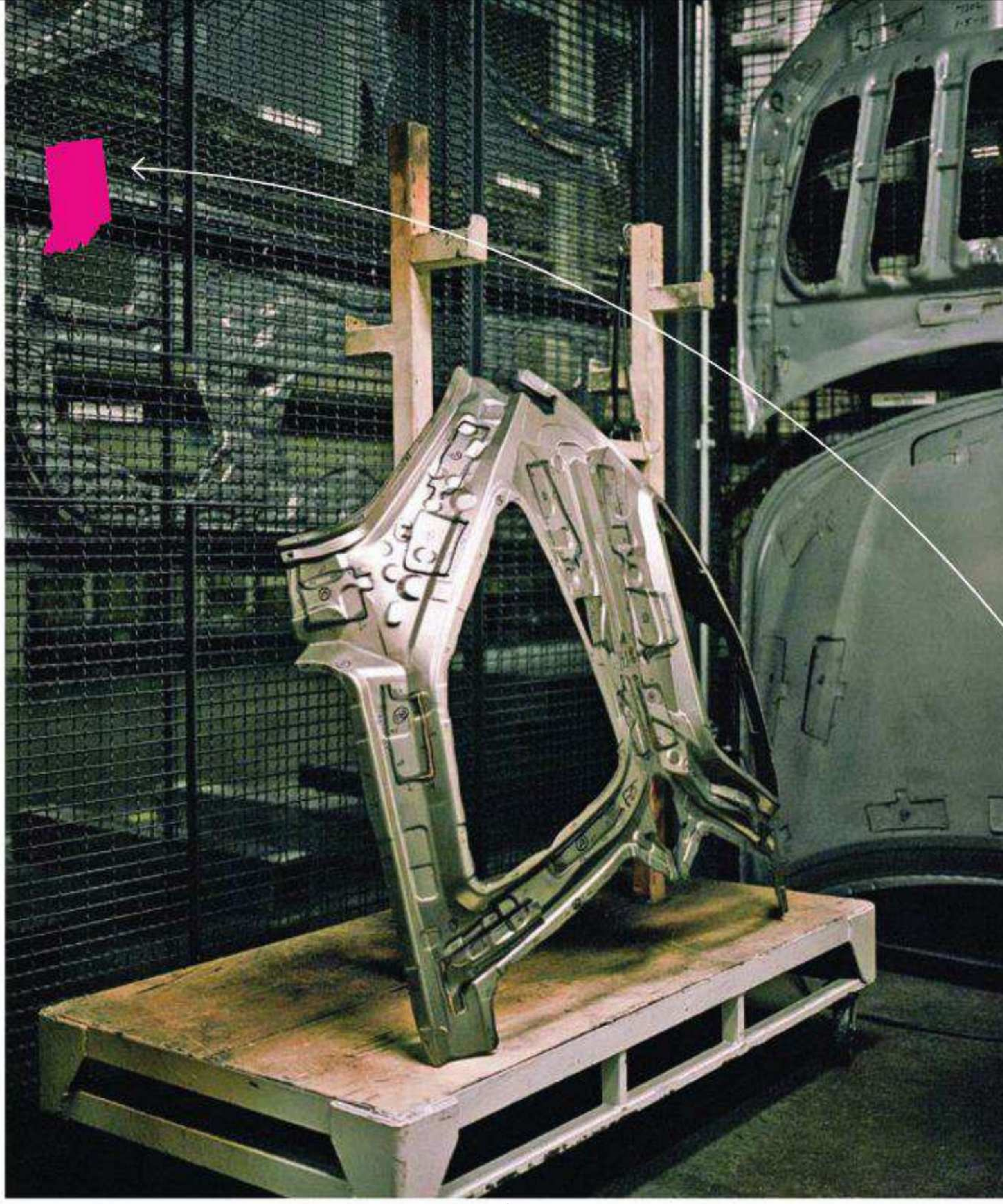
PAINT
Solvents used in the painting process are filtered and reused

CANADIAN RED WIGGLER
This indefatigable worm helps make compost from cubicle and conference room snack waste

WELDING
The use of copper welding tips has been cut by 75 percent. Copper slag is recycled

FUEL
Less than 2 percent of the plant's refuse is incinerated for power

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By custom ordering exact cuts of steel for its stamping machines, SIA saves 100 pounds of steel per vehicle

To score a cherished "associate" position at the factory—there's a 10-1 ratio of applicants to openings—would-be employees are expected to put in long hours learning and practicing SIA's low-impact manufacturing. That means scrutinizing every byproduct, from welding slag to plastic wrap, for savings. And obsessively slicing seconds off assembly procedures. And a willingness to work whole months of six-day shifts, and likely years on the graveyard shift, while resisting the siren call of unionization. (The United Auto Workers has failed three times to organize the plant's workers.)

There's always a catch, and at SIA it's this: All that ultra-efficiency—when applied to employees—can lead to unforgiving schedules. SIA workers, who start at just over $14 an hour and peak at about $25 an hour, put in 47-hour workweeks that include two Saturdays a month at time and a half—good for $50,000 to $60,000 a year in per-employee salary. (That means roughly 100 employee salaries were protected by the aforementioned $5.3 million zero-landfill rebate.) The upside? When the Japan earthquake interrupted the supply of parts in March, slowing down the plant's breakneck output, SIA was able to keep paying its workers in full to volunteer in town. The downside: "Everyone's burned out here," says Kay Tavana, a 48-year-old who installs airbags and headlights. Not that she isn't grateful for the work and the SIA perks. Working while on chemotherapy for a blood disease, Tavana avails herself of SIA's free gym to rev up for her shift from 4:30 p.m. to 3:30 a.m.

The cost savings and social programs at SIA wouldn't amount to much if Subaru's cars weren't in demand. From 2008 to 2010, unit sales jumped 41 percent, while last year the company's 22 percent rise in vehicle sales was double the broader car market's increase. "You get worker commitment to productivity by offering job security," says Kristin Dziczek, who studies labor issues at the Center for Automotive Research in Ann Arbor, Mich. "But the best job security is still a product people will buy."

With SIA operating at maximum capacity and with an expansion plan under way, Vice-President Easterday says this "experiment" in the middle of Indiana corn country could someday export its American-made Japanese cars to the rest of the world. His SIA case study left Schroeder convinced that "Dumpster diving can be great for business." B

For more on innovation and engineering in America, visit businessweek.com/go/11/innovation.



When supply containers are reused, workers hash-mark them. An example of the savings: More than $1.2 million worth of Styrofoam a year

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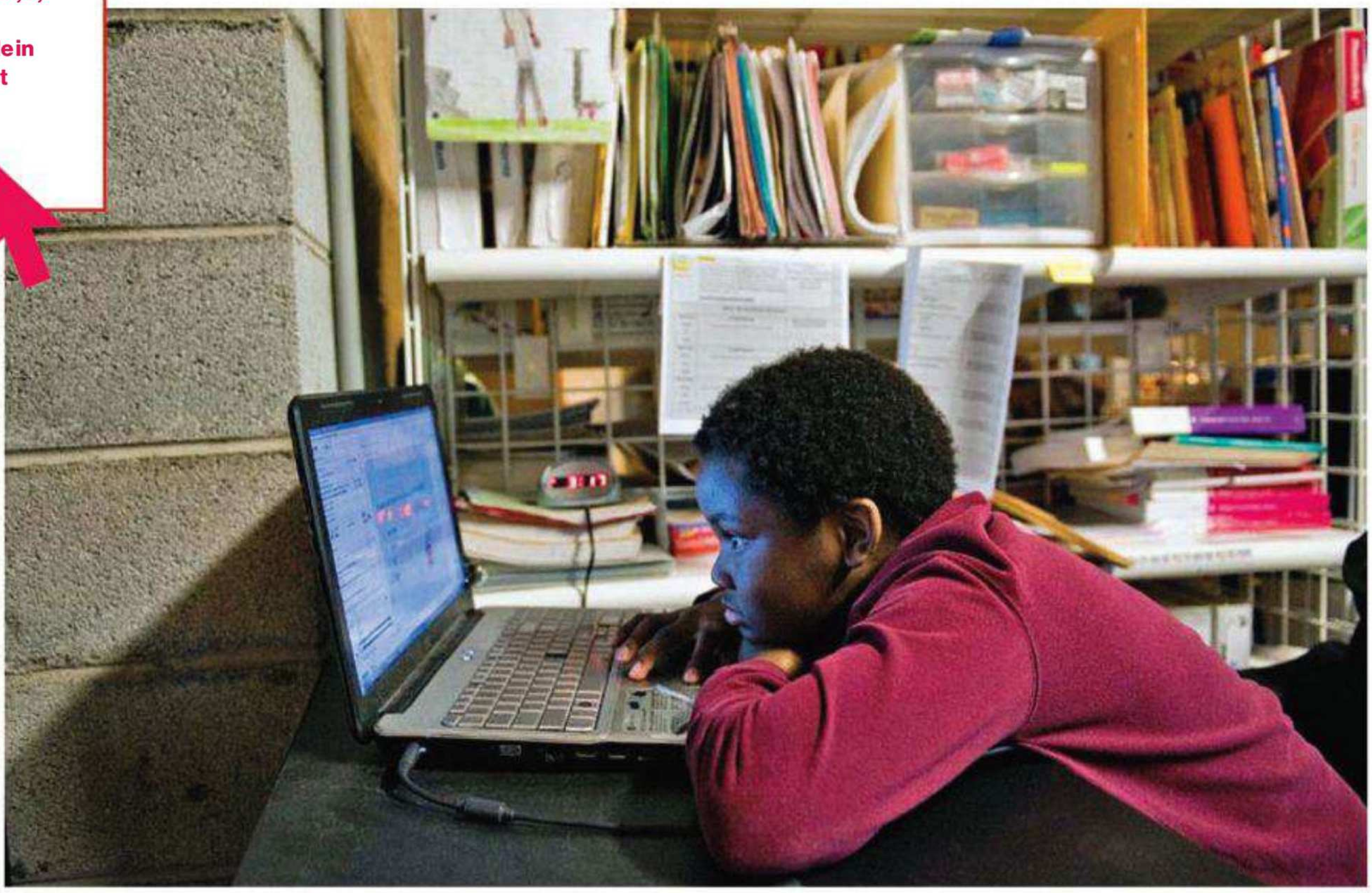


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Ayodeji Aderin, 8, attends the second grade in his basement

A Virtual Education

Former junk-bond king Michael Milken has figured out how to profit from online public schools. Is that a good thing?

By John Hechinger
Photograph By Peter van Agtmael

Ten-year-old Asiko Aderin is wearing headphones and staring into a computer screen, looking very much like an underage call center employee. It's a weekday morning–a school day–and this is what school looks like for Asiko and her two brothers, Ayomiro, 11, and Ayodeji, 8. Holed up in the basement of their family's Poconos, Pa., home, they watch lessons on a screen, typing answers to questions as their mother, Sharon Aderin, a former U.S. Army Reserve sergeant, hovers nearby. The children attend Agora Cyber Charter School, managed by K12, the largest U.S. operator of taxpayer-funded online schools and part-owned by billionaire Michael Milken.

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In a development that would have been unheard of a decade ago, about 200,000 U.S. school children are enrolled in full-time online programs. Eleven years after its founding, K12 has 81,000 students in 27 states and the District of Columbia. If it were a school district, it would be one of the largest in America. K12 expects to generate $500 million in revenue this year—it earned a $21.5 million profit last year—and its stock has doubled in value since the company went public in December 2007. The financial success of K12 has shown that Milken—the 1980s junk-bond king, convicted felon (securities fraud), and health-care philanthropist—has figured out how to profit from public schools. But while online education may have paid off for Milken and other investors, it's less clear that K12 is benefiting its students.

The company says its kids are making impressive gains in academic achievement, but a growing group of critics, including school superintendents and academic researchers, disagrees. They're concerned that online schools fail children and overcharge taxpayers—and that the money-making model that Milken has championed could be embraced more broadly as a way to overhaul public schools at the expense of actual education.

"This isn't going to turn out to be good for education or good for kids," says Diane Ravitch, an education historian and former assistant U.S. Education Secretary under President George H.W. Bush. "When you think about people in isolation, sitting in their basements at home, not having to learn how to deal with people, how to cope with cliques, how to work out problems with other children, how to function in a group, it strikes me this is a hugely dangerous direction for our society."

Some of the nastier elements of socialization, such as drugs, bullying, and early sexual behavior, are why Aderin, a devout Christian, chose an online school for her kids. As part of her fourth grade history lesson, Aderin's daughter, Asiko, volunteers to read off the screen after watching a video about Theodore Roosevelt and the Spanish-American War: "The whole country seemed to crackle with energy," she says, in a quiet monotone. "No one had more energy than Theodore Roosevelt."

K12 manages charter schools, independent entities that operate public schools without bureaucratic constraints such as contracts with teachers' unions. They've become the darlings of would-be education reformers across the political spectrum: Microsoft's Bill Gates, Wall Street hedge fund philanthropists, the Obama Administration, and many Republicans such as Jeb Bush and Mitt Romney. Over the past two decades charters have been promoted as a way to provide less affluent families with an alternative to conventional schools. K12's version is offered entirely online, with students taking classes and earning degrees at home in front of a computer, giving kids along every rural byway access to a charter education, as long as they don't mind getting it through the Web. "Bill Gates has invested [in education] without a real expectation of a return on investment," Michael Moe, an investment banker who helped take K12 public, says, comparing Gates's and Milken's contributions to the field. "Michael Milken believes that the greatest success in education will be tied to the marketplace." Or, as Ron Packard, the former Goldman Sachs banker and McKinsey consultant who co-founded K12, puts it: "Mike believes that education is a phenomenal investment opportunity." Milken's spokesman, Geoffrey Moore, says: "Mike is an investor but is not involved in the company's management."

The seeds for K12 were planted in the fall of 1999, near the peak of the Internet bubble, when Packard visited the Los Angeles offices of Knowledge Universe, Milken's for-profit education company. Packard wanted to start a business that would offer elementary through high school entirely online. Classes would be beamed directly into students' homes over the Internet. The schools would be operated for a profit. And—perhaps the best part—they would be funded by taxpayer money that usually goes to traditional public schools. Milken, now 64, his brother, Lowell, who is chairman of the family's philanthropic foundation, and Lawrence J. Ellison, the chief executive of Oracle, invested $10 million in Packard's startup, named K12. The Milkens have invested a total of about $90 million in the venture, Packard says. Knowledge Universe and other companies controlled by Milken and his brother own 19 percent of K12, a stake worth about $260 million, according to Securities and Exchange Commission filings. Packard says K12 is just beginning its growth trajectory as it pushes to enroll more of America's 50 million schoolchildren.

K12's headquarters are in a nondescript office park in Herndon, Va., along the high-tech corridor near Washington Dulles International Airport. The company has 2,400 employees, including 110 curriculum developers—among them former executives at PBS and the Smithsonian—who design and update the company's online courses. Along with running online public schools, K12 markets directly to homeschooling parents as well as to districts that want to start their own online classes.

One floor of K12's headquarters houses a call center, where 80 employees court students across the country—and the local, state, and federal money that comes with them. An online job posting for a K12 "enrollment sales consultant" says the applicant should "be able to close the sale with a customer" and "meet or exceed team and individual sales goals." Packard says K12's salespeople are paid primarily on salary, but part of their compensation is based on success in enrolling students. The U.S. Education Dept. has moved to ban the tying of recruiter pay to enrollment at for-profit colleges, saying the practice encourages employees to sign up students who might not benefit from the degrees (the ban doesn't apply to charter schools).

Packard dismisses any comparison. Whereas for-profit colleges are paid upfront, K12 is generally paid monthly. Because of initial outlays for computers and materials, Packard says, it loses money if students drop out after several months. "We don't want to

"Mike believes that education is a phenomenal investment opportunity," says K12's Packard

be recruiting kids who it's not right for," he continues. "That would be a disaster academically. It would be a disaster for the company economically."

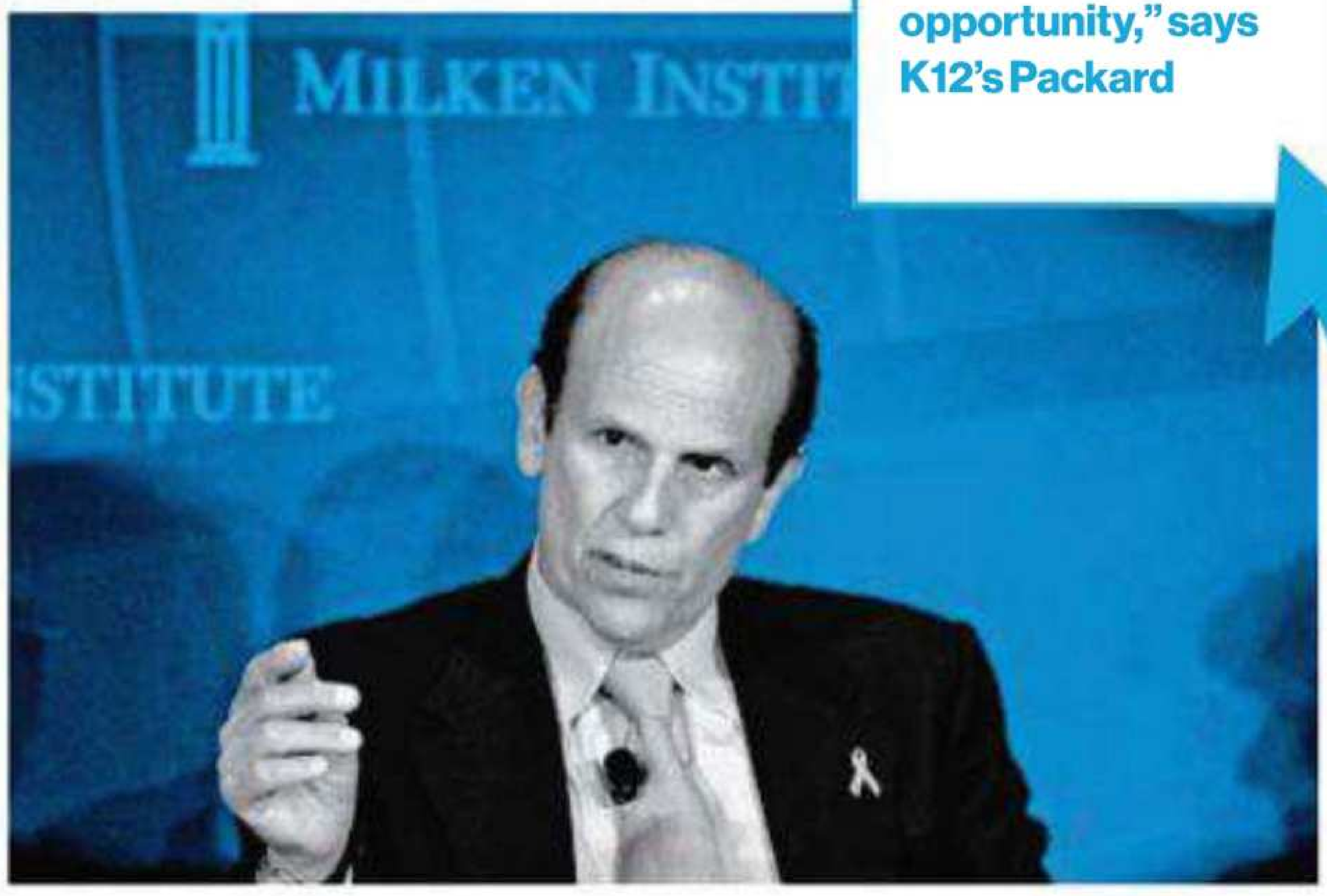
The Education Dept. says there is little valid research comparing online vs. face-to-face instruction for elementary and high school children. K12 did lag behind in a key measure—the percentage of students meeting the federal benchmark for yearly progress toward proficiency on state tests, according to a December 2010 study of companies running for-profit charter schools by researchers at the University of Colorado at Boulder and Western Michigan University in Kalamazoo. Three-quarters of K12 schools failed to show sufficient progress, compared with 45 percent of the physical charter schools in the study. K12's results are "just shocking," says Gary Miron, a Western Michigan University professor, one of the study's authors.

In part, this is a reflection of the backgrounds of K12's students, who tend to be poor and struggling academically, says Packard. The company is growing so fast that more than half its students are new each year, meaning they may take state tests five months after first enrolling, before they've had a chance to benefit from K12 teaching, he says. More than 90 percent achieved proficiency on state tests after seven years with K12, according to company literature. He adds that K12 has invested more than $200 million in technology and curriculum and that the company's schools, which collect money on a per-pupil basis, receive on average only 60 percent of a traditional district's allotment, which saves taxpayers' money.

Still, it's a difficult sell to some education scholars. "The enthusiasts for cyber learning have overstated the potential," says Tom Loveless, an education researcher at the Brookings Institution who did paid consulting for K12 in its early years. "What they keep forgetting is we're not talking about college students here. We're talking about high schoolers and young kids. The idea that parents go to work and leave their kids in front of a computer—it's absurd."

Michael Milken is a product of the traditional public school system—he graduated from Birmingham High in Los Angeles in 1964. After college at the University of California at Berkeley, he joined Drexel Burnham Lambert, where, during the 1980s leveraged-buyout boom, he pioneered the use of high-yield bonds to finance takeovers of companies such as Safeway. In 1990, Milken pleaded guilty to six felony counts of securities fraud and served a one-year-and-10-month sentence.

Since his release, Milken has become known for high-profile philanthropy, funding prostate cancer and epilepsy research and providing college scholarships through the Milken Family Foundation. He laid out his education philosophy at the annual Milken Institute Global Conference of movers and shakers held May 1-4 at the Beverly Hilton in Los Angeles. There, amid hundreds of CEOs and government officials, Milken released



an essay that bemoaned declining U.S. educational performance relative to Asia, and, in an implicit criticism of teachers' unions, complained that instructors are paid based on seniority rather than performance.

To address education and other major problems, Milken wrote, "In each case, the solution is the same: Unleash the energies of entrepreneurial people, and they will change the world."

After Milken agreed to back K12, Packard looked for a partner with education credentials to run K12 with him. He sought out former U.S. Education Secretary William J. Bennett, who had served in the Reagan Administration and had the conservative bona fides to appeal to the initial target market: homeschoolers, many of whom are conservative Christians. In an April interview, Bennett said that he liked the company's "world-class" curriculum, which features a firm grounding in American history and rigorous math instruction. (In 2005, Bennett, who hosts a syndicated radio show, resigned from K12 after making controversial remarks about blacks and abortion that he said were taken out of context.)

Packard says he speaks with Milken by phone as often as once a month. Milken will often call while on trips to China, India, and Indonesia, suggesting that K12 could broaden its international ambitions. "There's no reason why eventually you can't be educating a billion kids online," Packard says.

In Pennsylvania, the first state where K12 won approval to open a cyberschool, online education is both popular and controversial.

Under state law, charter schools, including virtual ones, are entitled to the same amount of local, state, and federal tax money that each student's home district spends, minus funding that traditional schools receive for transportation, capital outlays, and debt service. Of course, online schools don't have to operate cafeterias or gyms, either. K12 says that under Pennsylvania's formula, which is among the nation's most generous for charters, it gets 80 percent of the funding of traditional schools. That came to about $8,000 per student, on average, according to a February state filing.

Charter schools must also be nonprofits under Pennsylvania state law, although the schools'

JONATHAN ALCORN/BLOOMBERG

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- 16th largest economy of the world and the 6th largest economy as compared to the EU countries in 2009 (IMF-WEO)
- 15th most attractive FDI destination for 2008-2010 (UNCTAD World Investment Prospects Survey)
- Fastest growing economy in Europe in 2010

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boards can choose a for-profit management company to run them. Agora's volunteer board is made up mostly of parents of children at K12 schools. "It also charges Agora separately for instructional materials and online courses. In the year ended June 30, K12 received $31.6 million from all those sources, Agora reported on its tax form—or 8 percent of K12's revenue. With peak enrollment of 5,500 last year, Agora, the only K12-operated academy in Pennsylvania, can enroll students anywhere in the state.

Pennsylvania Auditor General Jack Wagner issued a report last October saying that Pennsylvania's 11 cyber charter schools may be receiving too much tax money, given their lower costs. Don Bell, superintendent of Pennsylvania's Northern Lebanon School District, says he was able to open an online school for his students for a third of what K12 charges. "I support school choice," Bell says. "I just don't think you need to be ripping off everyone to provide it."

In response, K12 says the state sets funding levels for all charter schools. School districts that say they are spending far less for online instruction "don't care about quality," says Packard. K12 also offers field trips and other face-to-face get-togethers and is introducing physical learning centers that serve about 5 percent of its students nationally.

In a state filing last June, Pennsylvania's Acting Education Secretary Thomas Gluck demanded that Agora improve performance on state tests or risk losing its charter. On the latest round of assessments, for 2009-10, 55 percent of Agora students were considered proficient or above in reading, compared with 72 percent statewide. In math, 47 percent achieved that benchmark, below the 75 percent state average. K12 says Agora has lower test scores in part because 63 percent of its students are eligible for the federal free or reduced-price lunch programs, a measure of poverty, compared with the 39 percent state average. By another state yardstick—students' improvement over each year—the company says Agora ranks among the top schools in the state.

One of Agora's most successful recent graduates points out that K12 attracts students who aren't necessarily suited for independent online work, resulting in heavy turnover: Almost a third of the 7,700 students Agora signed up withdrew last year. "I think cyberschool was the right choice for me," says Darian Kiger, Agora's 2010 valedictorian, who delivered a live speech to the graduating class at an evangelical church and conference center. Kiger, now a 19-year-old freshman at York College in Pennsylvania, says: "I don't think it's the right choice for everybody."

"I support school choice," says a district superintendent. "I just don't think you need to be ripping everyone off to provide it"

That was the case for one student, Cortnie Ettinger, who left the ninth grade at her high school in the Central Susquehanna Valley in 2007 and enrolled in Agora instead. She eventually stopped logging in to her virtual classes and spent her days watching TV or hanging out in the park. Ettinger, now 19, has since returned to a traditional high school, where she made honor roll last year. Of online education, she says: "I wouldn't recommend it for my kid."

Cyberschool truancy is a common problem, according to many school districts. At least 15 percent of the students enrolled in cyberschools in Pennsylvania's Bangor district end up as virtual truants, Superintendent Patricia Mulroy estimates. As Mulroy puts it: "We pay for them, even though they haven't logged in."

Most of the time, K12 students study on their own, clicking on lessons, doing exercises, taking tests, with teachers available by e-mail and phone for support. For younger kids, this largely independent enterprise means that parents act as classroom monitors—in the company's parlance, they're "learning coaches." This free labor is a boon to K12's business model because it conscripts a corps of committed parents as instructors, cutting out some of the cost of hiring trained teachers, with their union wages and benefits.

Sharon Aderin's two boys also receive up to an hour a week each of speech therapy online, via headset, microphone, and Web conferencing. That means that Agora gets almost $22,000 for each Aderin boy annually from their Stroudsburg school district under state funding rules. (Aderin's daughter used to receive such help but is now receiving only general-education services, for which Agora gets just under $10,000 a year.)

An hour a week of speech services would cost the Stroudsburg district about $1,500 a year, according to Business Administrator Don Jennings. But Agora is receiving "a windfall" when it bills $22,000 a year for students receiving what he described as "very minimal services." (K12 says other children with disabilities can cost two or three times the amount it receives, and the company also delivers special-education services in therapists' offices and at home.) Aderin says she's delighted with the education her children are getting from Agora and notes proudly that they are scoring high on state proficiency tests. But she says she had no idea of the cost to taxpayers.

"Wow," she says. "For that, I could have them in private school. It seems high to me, especially since I'm doing most of the teaching." B

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Natalie Wood, design engineer at the River Bend nuclear energy facility in Louisiana.

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The Rumsfeld cruise ... and other high seas adventures
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The Online Reviewing Mafia

The $500-million website Yelp grows on the strength—and grumpy volume—of its Elite food critics. *By David Sax*

FROM TOP: JOHN LUND/GETTY IMAGES; LUDOVIC/REA/REDUX

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Etc. Crazy Foodies

Outside the Project One gallery in San Francisco's design district, a young woman dressed as an ice cream sundae is standing beside the velvet rope. Inside, a throng of young professionals binge on free wine and brownies as they're feted by a man dressed as a cupcake and another as a gingerbread cookie. This so-called Sugar High soiree is not a child's birthday party. It's an exclusive event honoring one of the foodie world's most influential sects: the Yelp Elite Squad, the search website's cognoscenti.

In the strange, exclamation point-laden netherworld of online restaurant reviewing, the Elite are a chosen people. They're selected each year through a clandestine Skull and Bones-like process that evaluates the quality and extraordinary quantity of their Yelp.com review writing and their popularity among the San Francisco-based company's millions of users who rely on the site's recommendations to pick, among other things, a lunch spot, after-work bar, or client dinner joint. Adding to its aura, Elite status is proffered by a governing body known as The Council, which is also shrouded in mystery. Says Andrea Rubin, Yelp's vice-president of North American marketing: "We don't share how it's done."

Yelp also refuses to divulge the total number of Elites worldwide, but industry estimates put the figure in the low thousands. It's a motley crew of tastemakers from St. Louis to Lyon—students in their twenties, marketers in their thirties, housewives in their forties, engineers in their fifties, venture capitalists in their sixties, and one 89-year-old great-grandmother living in Los Angeles. Together, this restaurant-reviewing mafia has the power to build up businesses—and take them down. "It's a huge force to reckon with," says Brandon Arnovick, the owner of Mission Minis, a San Francisco cupcakery. "These people are beyond just hobbyists." Says industry analyst Jeremiah Owyang of the Altimeter Group, a San Francisco market research firm: "They're the new Zagats."

Selection to the Yelp Elite is the online food review equivalent of the Skull and Bones

The Elite tribe was founded in 2005, a year after Yelp's inception, to gain influence over the restaurant business and encourage user-generated content. Yelp co-founder Jeremy Stoppelman and then-brand manager Nish Nadaraja wanted to reward the site's most prolific reviewers and spur them to continue to draw traffic—without, of course, actually paying them. So they granted these voracious users "elite" badges on their profiles and access to parties—most of which, of course, Yelp got someone else to pay for.

Events, now held monthly, are generally underwritten by local businesses hoping to market themselves to the Elite. They range from winery tours to 4,000-person Yelpapaloozas (coming this summer to the Bay Area) to goofy parties where people dress up like cupcakes. "It's counterintuitive for an Internet business to bring people together offline," says Greg Sterling, a San Francisco-based Internet analyst. "Bringing these people together in the physical world was smart, because it strengthened the community." And it's worked like a charm—albeit for a certain personality type. "The primary perk is getting to go to the parties," says Becca Shansky, a retired member of the New York group. "Free booze and food, plus you get to see all your friends and geek out about restaurants. It's an incentive to stay involved, as we're obviously generating content for Yelp at no charge."

This free-labor mind trick has helped bolster the company's geographical expansion—its key source of revenue growth—as it attracts new users and adds to the number of restaurants reviewed. In the past two years, Elite Squads have been launched in Paris, Toronto, London, and Vienna, and in less renowned culinary capitals such as Pittsburgh, Calgary, and Leeds. In all, there are more than 60 Elite Squads throughout North America and Europe. "The nucleus of Yelp is that community," says Nadaraja, who is no longer with the company but retains a share of equity. "Anything coming in—advertising, sponsors, etc.—is all based on that." Silicon Valley firm NeXtup Research recently valued Yelp at more than $500 million.

For the Elite, the rewards of composing daily, adjective-rich, multihundred-word-long restaurant reviews are much less clear. While some have tried to use their status as a platform for greater foodie glory, few have succeeded. Ed Uyeshima leveraged his membership into a travel writing gig at the *San Francisco Examiner*; New York Elite Chris Hansen parlayed his cult popularity into work at the somewhat influential midtown Manhattan lunch website midtownlunch.com. Last fall power reviewer Libby Rego earned a guest spot on Gordon Ramsey's reality show, *Hell's Kitchen*. And those are the success stories.

For others, the rewards are personal. San Francisco architect and amateur pickled meats expert Theodore Ordon-Yausi, 26, was tapped in 2010 after attending the "Elite Prom" as a plus-one. "My reviews are defi-

"The nucleus of Yelp is [the Elite] community," says former brand manager Nadaraja



IMAGE SOURCE/AURORA PHOTOS

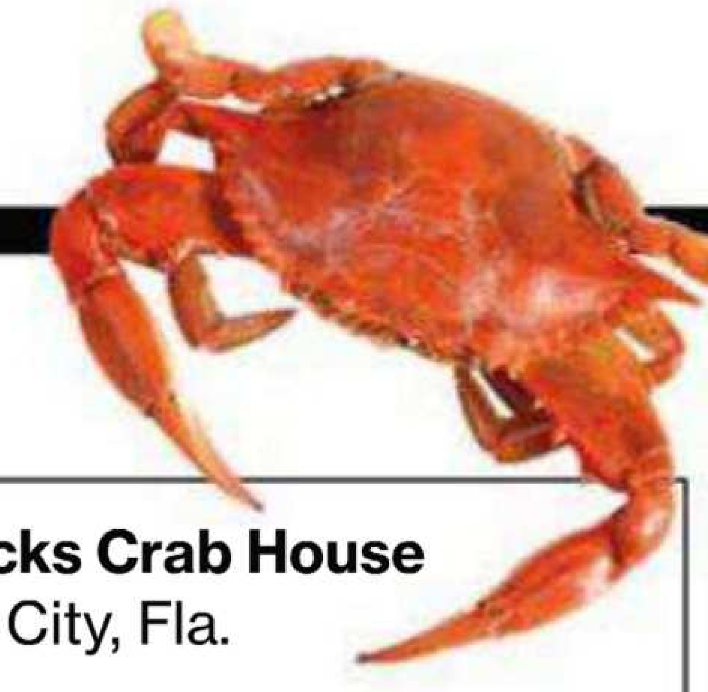
WorldMags

Whine 'Em and Dine 'Em

Yelp Elite members are known for their prolific reviewing virtuosity—and their occasional cattiness. Here are some snippets. —*Spencer Bailey*

Blue Coast Burrito
Nashville

"This place is just an utter disaster. ... The staff is just crap. I don't know how else to say it. I've been treated with more respect and seen happier staffers at McDonald's. This place is garbage. Do not eat here."



Dirty Dicks Crab House
Panama City, Fla.

"The best part of this restaurant is the catchy name. Come to think of it, it might be totally appropriate." —*Russ M.*

Esquina
Lawrence, Kan.

"I found the prices outrageous for what I considered to be a boring, flavorless meal. If I'm going to spend $8 on three tacos again, I'll do it at Chipotle. And, for the record, I don't even really like Chipotle."

—*Christina M.*



Sports Radio 810 Zone
Leawood, Kan.

"Think of an Applebee's. Then add $1 to $3 to everything on the menu. Then remove 75 percent of the women...and replace them with dudes."
—*Stephen K.*



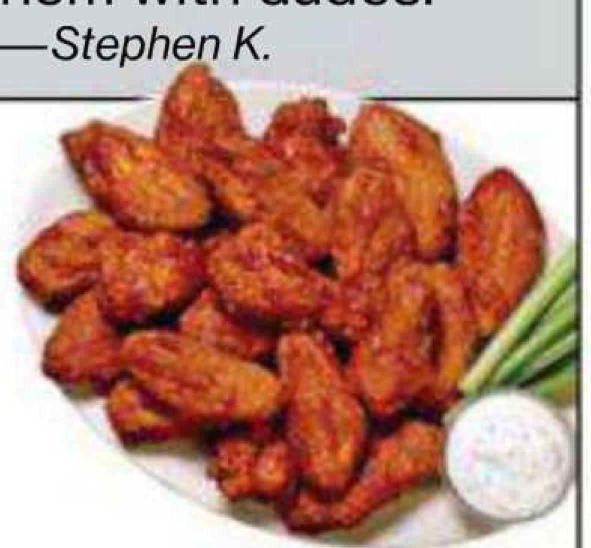


Red Robin Gourmet Burgers
Wasilla, Alaska

"Noteworthy was the fact that Willow Palin and her boyfriend and his friend came and sat and sat and sat and sulked and got the same sh--ty service we did." —*Geordie B. C.*

Pinkberry
New York

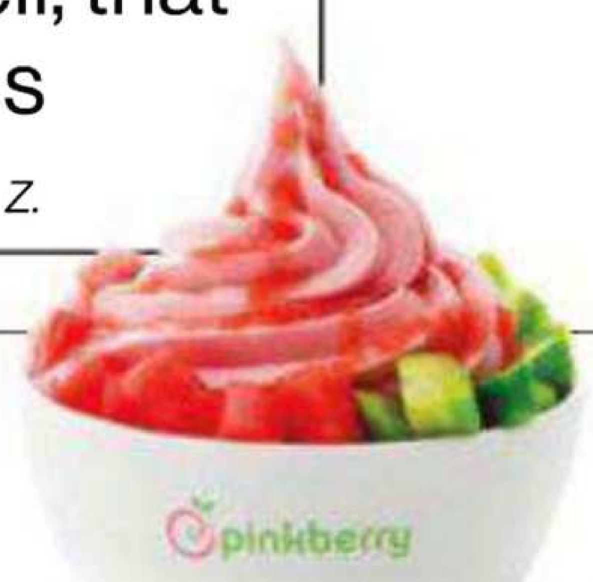
"Few things in life enrage me. Big gaping holes in the middle of my frozen yogurt swirl is one of them. Well, that and stingy motherf-----s with the toppings." —*Cecilia Z.*



Gold Mine Saloon
New Orleans

"The Gold Mine is torture. This is possibly my least favorite bar on earth. I have never liked it, even though I was forced to come here on many occasions. Why, you ask? For some reason, girls have always liked this bar." —*John L. H.*





nitely read more now," says Ordon-Yaussi, who writes under the nom de plume The King of Pastrami. "I get more random messages from people I don't know. I have 20 new fans who follow my reviews." That can be invigorating. "I like to tell my friends that my opinion is important," says 29-year-old research scientist Kristin Patrick. "When I go into a restaurant, the owner says, 'You're here to write a review, aren't you?' I'll say, 'Don't worry, I'm Elite.'"

Yet with clout can come hubris. A recent fracas among Elite users in Los Angeles and Vancouver resulted in several account deletions. Houston Elite member Edgar V maintains a Web page of businesses he feels are "Evil and Must be Destroyed." And while this includes massive corporations such as Bank of America, it also lists Van's Chinese Seafood Restaurant in San Antonio—on whose Yelp page Edgar V's scathing review is listed first. And then there are persistent entitlement issues. This spring, Yelp's New York community manager sent a letter to Elites after a party at Club A Steakhouse turned into "abject terror." One waiter at the restaurant, the letter said, "was absolutely traumatized by the rabid ferocity with which certain guests attacked his plate of hors d'oeuvres." It wasn't the first time. "The staff at several events," read the dispatch, "has commented on the fact that occasionally some members of the Elite Squad at meals can be likened to an Animal Planet feeding frenzy."

"It's a huge force to reckon with. These people are beyond just hobbyists," says one cupcake store owner

The Elite Squad's greatest threat may be itself. As Yelp continues to develop its *haut monde*, Elites face a future in which their cult influence is being betrayed by their growing numbers. With Yelp pushing mobile device searches, which account for one-third of all searches on the site, the utility of the hyperbole-rich essays is also declining. For some, it's the end of an era—and time to get a more productive hobby. "On a personal level, I got what I needed out of it and moved on," says Christie Day-Gee, a Chicago real estate broker who relinquished her badge last year. Retired engineer Phil Anderson, a member of the 2005 inaugural class, agrees. "I still write reviews," he says, snapping a picture of some osso bucco at San Francisco's South Harbor Restaurant and uploading it for a future review. "Instead of a review a day, I do one a week." But Anderson, who also gave up the badge, is O.K. with that—at least sort of. "Life evolves," he says, "and you move on—to some degree." B

WorldMags

Etc. One True Thing

The Summer Raincoat

Gryphon's modern twist on the trench coat is ready for its moment in the sunshower

The Want: A lightweight trench coat with feminine flair. It should keep you dry during pesky summer rains and be smart enough to wear on crisp sunny days. Think Katharine Hepburn, not Mary Poppins.

The Get: Gryphon's Studded-Belt Trenchcoat ($480, saksfifthavenue.com). The timeless double-breasted coat is updated with two removable belt options for a more flattering silhouette. The water-repellent twill and shoulder storm flap will save you on a rainy day, while the A-line hem and the epaulet shoulder details ensure a look that will be a go-to for rainy seasons to come. Ⓑ —*Alexis Brunswick*

WAIST MANAGEMENT

Four unusual trench belts to brighten a rainy day



1. Bling It Up
Marc by Marc Jacobs's gold metal design provides all the accessorizing an outfit needs. *$180, net-a-porter.com*

2. Getting Buff
Match your wellies with a shiny black, brown, blue, or red J. Crew ½-inch wide patent belt. *$32.50, jcrew.com*

3. The Nautical Look
Exude a seaside vibe with the marine-inspired knots on this Tory Burch snap-close belt. *$165, toryburch.com*

4. The French Connection
Wrapped around the waist, this Juicy Couture silk scarf is a nice contrast to a coat's tough hardware. *$68, juicycouture.com*



The storm flap—a typical trench coat feature—prevents rain from seeping through buttonholes

Gryphon's studded belt adds some grit

Before she founded Gryphon, designer Aimee Cho was a *Vogue* writer in search of the perfect trench. She launched her fashion label to reinterpret this wardrobe staple

TRENCH: PHOTOGRAPH BY NICK FERRARI FOR BLOOMBERG BUSINESSWEEK

WorldMags

The Sea List

The cruise business is expanding through a strange—and sometimes shocking—array of themed voyages. Don't forget your Pepto. *By Steven Daly*

Theme cruises account for 7 to 10 percent of the $28.9 billion cruise market, according to InSight Cruises



START HERE

ANNOYING

History Channel Experts lecture on the Civil War, World War II, and Caribbean history. *From $2,074, seven nights*

American Girl Dolls get their own teacup at dinner. There's even a doll hair salon. *$3,313, seven nights*

National Review The right-wing journal launched its maiden voyage in 1994. *$1,899, seven nights*

Sarah Palin hosted *National Review* cruise passengers at the Alaska governor's mansion in Juneau in 2007

VH1 This year the "Best Cruise Ever" featured concerts by Train, Lifehouse, and Colbie Caillat. *$799, four nights*

A.C. Milan Cruising with soccer players isn't the only draw: Coaches teach clinics and organize matches. *$1,501, seven nights*

The Biggest Loser Lose pounds alongside former show contestants. Experts also advise on nutrition and fitness. *$1,295, seven nights*

ALARMING

Richard Simmons Sweat with the fitness legend on his "Cruise to Lose." *$1,245, seven nights*

Macs The 11th MacMania trip offered seminars on apps and social media. *$1,888, seven nights*

American Conservative Union Get chummy with Rummy. *$1,630, seven nights*

Backstreet Boys The ship docks in Nassau for a private beach party and BSB concert. *$699, three nights*

Star Trek Past Cruise Trek cruisers have been joined by motley cast members. *$899, seven nights*

Prairie Home Companion Garrison Keillor's cruise is already full. *$1,900, seven nights*

The North American cruise industry is expected to grow 6.6 percent in 2011, according to Cruise Line International Assn.

APOCALYPTIC

Little House on the Prairie Fans can sail with the cast—sans the late Michael Landon. *$879, seven nights*

Twilight Fans were disappointed to learn the second annual cruise was canceled. *$1,049, seven nights*

Kid Rock Getting wasted was the main form of entertainment on the Detroit rock renegade's April sea adventure. *$899, four nights*

Book of Mormon Cruisers explore ports with significance to the religious text. *$559, seven nights*

Young American Foundation Cruise with Karl Rove—for a hefty fee. *$7,800, eleven nights*

Titanic Yes, a cruise honors the sunken ship. *$1,490, twelve nights*

CAILLAT: DAVID BECKER/GETTY IMAGES; MILAN: DINO PANATO/GETTY IMAGES; ROVE: MARK WILSON/GETTY IMAGES; KEILLOR: ANDREW HARRER/BLOOMBERG NEWS; KID ROCK: JASON MERRITT/GETTY IMAGES; RUMSFELD: JASON MERRITT/GETTY IMAGES

WorldMags



Happy hour etiquette expert George Wendt

The Slosh Pit

How you behave around your colleagues during happy hour can say a lot about you. *By Tim Murphy*

For better or worse, the *Mad Men* era is long gone. On-the-job cocktails and the office hijinks that often accompany them are verboten in these litigious, politically correct times. Yet one thing hasn't changed since Don Draper's more-or-less-consequence-free saucing: "People need to blow off steam after work," says actor George Wendt, best known for playing the curmudgeonly and ever-present barfly Norm on *Cheers*. These days, the only appropriate window for liquor-fueled co-worker co-mingling is the margarita-and-nacho-heavy ritual we call happy hour.

This poorly lit pastime, however, is usually fraught with tension. "There's often an undercurrent of sexuality, fueled by ethyl alcohol," says body language expert David Givens, author of *Your Body at Work*. "You're drinking and eating in the pleasurable rest-and-digest mode. Emotions become exaggerated." Especially when the wrong person gets control of the jukebox.

What are your nonverbal cues saying about you? *Bloomberg Businessweek* recently observed 100 happy hour patrons in New York, Washington, and Philadelphia. We categorized their habits, which were then decoded by our panel of experts: Wendt; Givens; Joe Navarro, author of *What Every Body Is Saying*; Patti Wood, co-author of *Paid to Speak*; and Patrick Lydon, a bartender at New York City's 119-year-old Old Town Bar. Next time think twice before you start dangling your shoe as you swivel on that bar stool—unless you really don't want to go home alone. **B**

15% *(of people observed)*

Bro-Tastic Touchers

Men who give copious high-fives, backslaps, and the occasional fist bump are engaging in "a dominance display," says Navarro. "It's intended to get them noticed—to show who's the biggest silverback ape." Adds Wood: "This is acceptable touching for heterosexual men." Wendt: "These are stages of relaxation."

13%

Impromptu Boogiers

Sudden, brief eruptions of dancing to old Wham! or Guns N' Roses songs expresses "joy bubbling up without sanctions," Wood says. Givens says people are "seeking attention by moving," while Navarro notes, "smooth movements are psychologically attractive." Lydon: "They're either ready to go home with somebody or they're drunk. Or both."



12%

Bar Belly-Uppers

Guys sitting elbow to elbow at the bar, glued to a game "may not think they're interacting, but they feel they're on the same team," says Givens. Adds Navarro: "Their bodies are echoing each other in perfect synchrony as friends." Wood: "Guys touch side to side. It's relaxed camaraderie," especially if they've been in battle mode at work.

3%

Nervous Munchers

Women who nibble minutely on nachos are "starving but trying to look feminine," Wood says. "If she's doing something repetitively, like creasing her oyster crackers packet, it means she needs to control the situation." Givens says, "Crunching snack food harkens back to primates eating nuts and berries."

Weird But Less Common Happy Hour Behavior ▶ BEER-BOTTLENECK-CHEST-TAPPING MEN/ **Givens:** "It's like a CAMP'S *SMALL TOWN* / **Navarro:** "Some songs are very tribal." ▶ A GROUP OF DRUNKARDS HUDDLED TOGETHER, BUT NOT AROUND A TABLE /

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6%

Disrobers

"You're saying, 'I can relax and don't have to be alpha anymore,'" says Woods of the men who untuck their shirts and women who take off their heels and jackets at the bar. "It's a display of freedom and unconventionality," says Navarro. Givens: "It's the new taking off your tie." Lydon: "They're one step closer to going home together."

17%

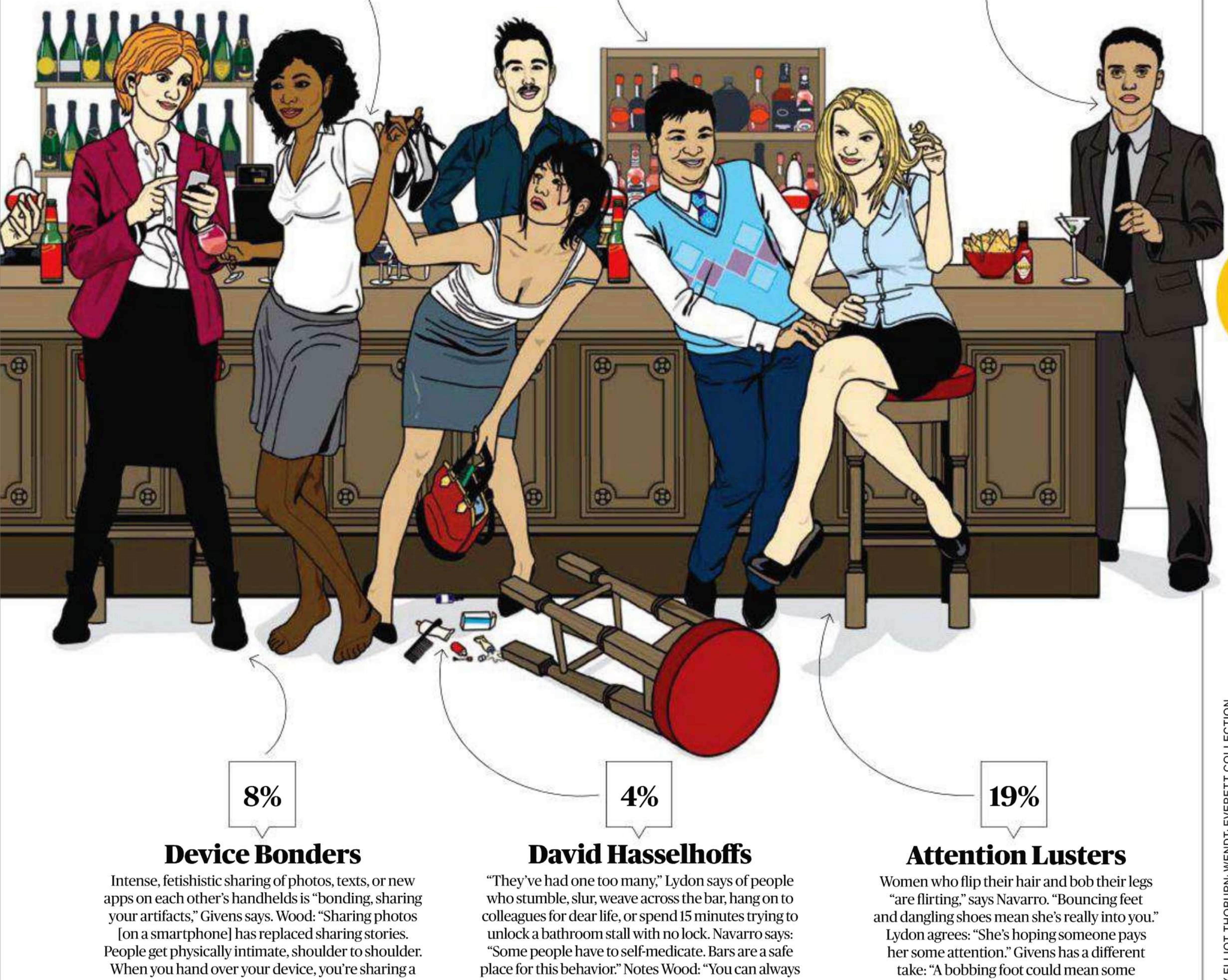
Sloppy Power Huggers

"You don't have to be as PC as at the office," says Wood of cocktailing colleagues who engage in excessive, extravagant hugs and kisses and rejoice in simply being co-workers. "You're out of the office but with your tribe," says Navarro. Wendt adds: "I guess that's alcohol doing its thing."

2%

Solo Drinkers

"They're alone in a crowd, finding comfort in a noisy environment," says Navarro of people who idle to the side as their co-workers have a rip-roaring good time. Givens thinks, "You're secondhand socializing, like [inhaling] secondhand smoke." Says Wendt: "I try to fly under the radar, but someone always yells out: 'Norm!'"



8%

Device Bonders

Intense, fetishistic sharing of photos, texts, or new apps on each other's handhelds is "bonding, sharing your artifacts," Givens says. Wood: "Sharing photos [on a smartphone] has replaced sharing stories. People get physically intimate, shoulder to shoulder. When you hand over your device, you're sharing a part of yourself."

4%

David Hasselhoffs

"They've had one too many," Lydon says of people who stumble, slur, weave across the bar, hang on to colleagues for dear life, or spend 15 minutes trying to unlock a bathroom stall with no lock. Navarro says: "Some people have to self-medicate. Bars are a safe place for this behavior." Notes Wood: "You can always just say, 'I was *sooo* drunk.'" Wendt: "I don't judge."

19%

Attention Lusters

Women who flip their hair and bob their legs "are flirting," says Navarro. "Bouncing feet and dangling shoes mean she's really into you." Lydon agrees: "She's hoping someone pays her some attention." Givens has a different take: "A bobbing foot could mean some social anxiety."

gorilla's chest-beating. You're showing off your big, male, knobby hand." ▶ **BIG GROUP FIST-PUMPING TO JOHN (NÉE COUGAR) MELLEN-**

Lydon: "They almost create a bonfire." ▶ **ONE WOMAN WITH TWO PINTS AND NO FRIENDS** / **Lydon:** "She has a drinking problem."

ILLUSTRATION BY ELLIOT THOBURN; WENDT: EVERETT COLLECTION

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Could a garage-dwelling twentysomething bioengineer become the next Craig Venter?

The Biopunk Movement

A grass-roots phenomenon is ready to splice up the next billion-dollar idea. *By Daniel Grushkin*

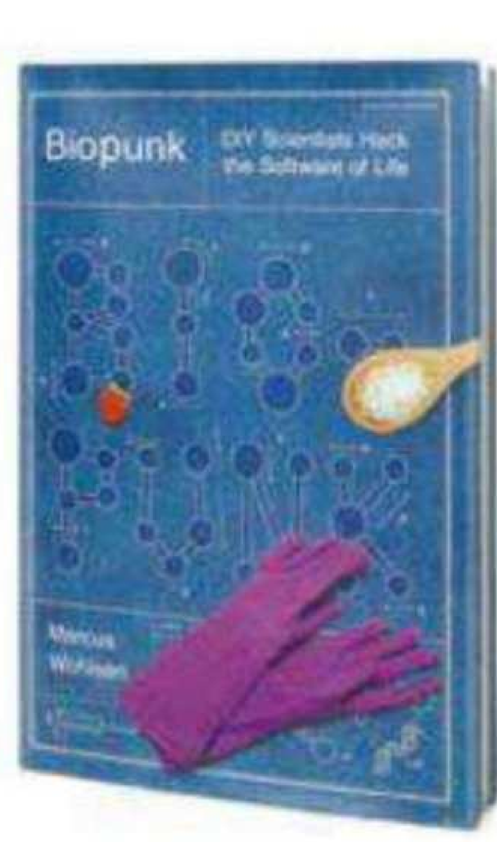
I first dabbled with genetic engineering two years ago in my apartment. A dozen strangers I'd met online hovered around a cherry dining room table while molecular biologist Ellen Jorgensen and I coaxed a new set of genetic instructions into a vial of bacteria. The new code, originally from jellyfish, successfully programmed the bacteria to glow green. It was a meager introduction to biotechnology. Afterwards, we ate pizza.

Still, Associated Press science writer Marcus Wohlsen would call me a "biopunk." And his book by the same title introduces the grass-roots movement of biotech enthusiasts who are moving genetics beyond traditional labs—and into kitchens, garages, and workshops. For the uninitiated, that probably sounds incredibly dorky or incredibly creepy. Wohlsen weighs both hypotheses and arrives at a third: Biopunks, he argues, are on the edge of a technological revolution comparable only to the one started by the shaggy übergeeks who built the first personal computers.

i

Biopunk: DIY Scientists Hack the Software of Life

By Marcus Wohlsen
CURRENT
256pp; $25.95



Like programming nerds, biohackers may have some social quirks, but their gatherings also share the same potential for creative disruption. These hackers, Wohlsen explains, come to biology for a multitude of reasons: some for the pleasure of learning, others for the power of bending life to their whim. The movement has also produced a burgeoning class of entrepreneurs who see the kernels of billion-dollar ideas coming out of their biotech playtime. While the first biohacker tycoons have yet to emerge, Wohlsen believes they may well be on their way.

He's not the only one. Tom Knight, a tech-guru-cum-biotech-patron, tells Wohlsen that the Biotech Age will do to the physical world what the Information Age has done to data. His thesis is rooted in the cell, which he considers the most perfect manufacturing platform ever made. "I think there's a good chance we can transition from a world where manufacturing is capital-intensive to one where the cost of manufacturing is on the same par with the cost of replicating information," Knight says. In other words, the majority of manufacturing capital won't be spent on raw materials and machinery—rapidly reproduc-

ILLUSTRATION BY CIARA PHELAN

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ing cells can take care of that. In a sense, the cells will behave both as the factory and the product.

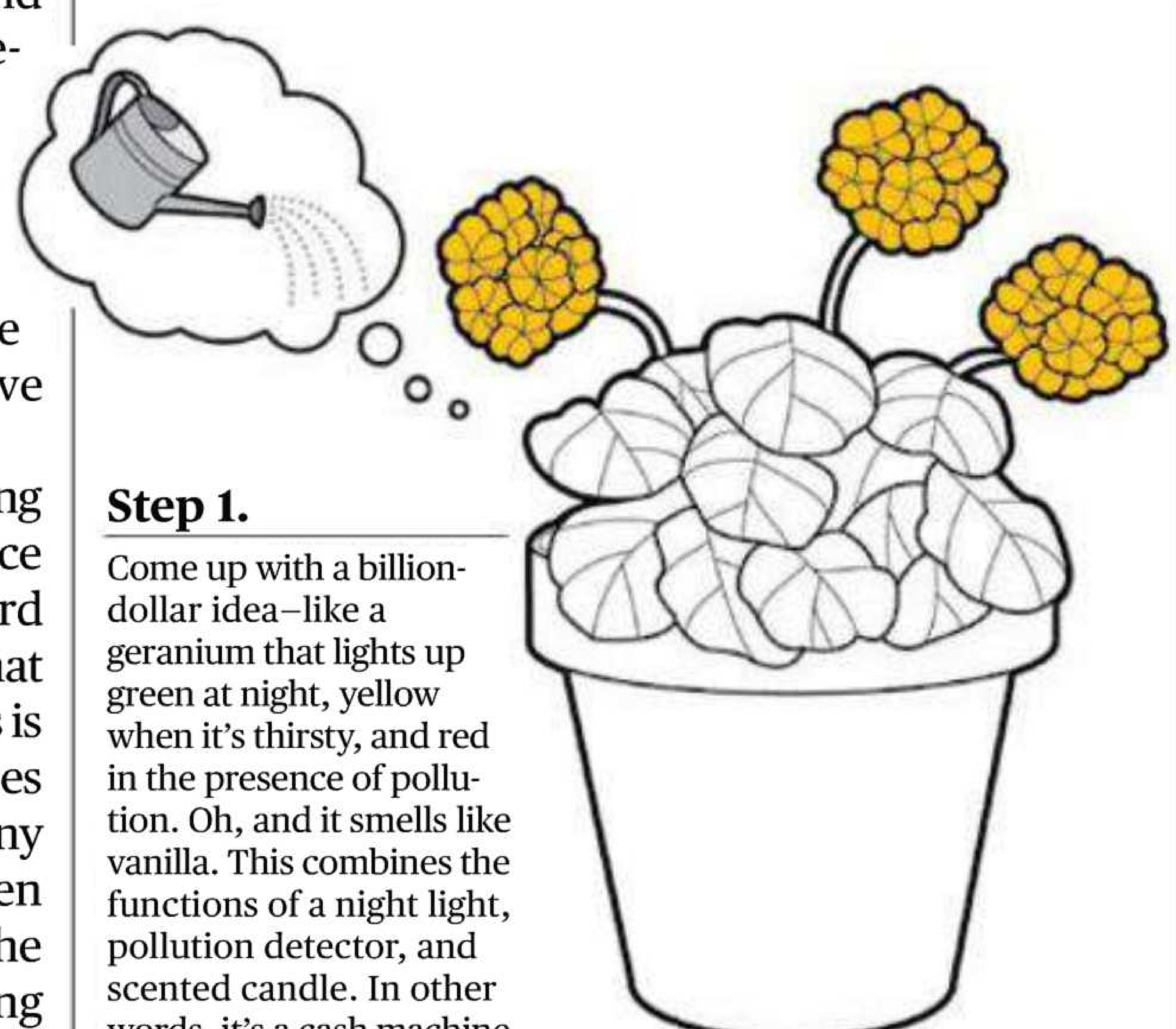
Knight's idea sounds kind of crazy, but it's already taking shape. Scientists are now trying to produce raw materials from genetically modified (GM) organisms. Dozens of biotech companies are also scrambling to replace fossil fuels with GM crops and algae. Chemical companies are teaming with enzyme designers to grow plastics straight from bacteria. And in academic labs, there are early signs that bacterial cells may soon be self-assembling into useful objects. Massachusetts Institute of Technology biologist Angela Belcher, for example, grows batteries and solar panels using GM viruses. As the technology improves, there's a very good chance we'll be able to mold these cells into things we've never even fathomed.

The secret behind manipulating cells into building what we want, however, lies in our ability to sequence and synthesize DNA. And the problem, as Stanford University professor Drew Endy tells Wohlsen, is that right now "we suck at engineering biology." And this is where the biopunks come in. The Gateses and Jobses of biotech will emerge only when we throw as many eyes and hands at the problem as possible. Wohlsen profiles the young people who aren't just pushing the bounds of DNA programming, they're also making bioengineering cheaper and more accessible. Two of them, Joseph Jackson and Guido Núñez-Mujica, he writes, are prototyping the LavaAmp, a machine that copies DNA—and is the size of a cell phone. The LavaAmp plugs into a computer and is intended to retail for $100. Wohlsen describes how another punk, Tito Jankowski, broadcast open-source blueprints for lab equipment online. The young man with the minuscule budget already has enough to revolutionize an industry that until now was too expensive.

Although *Biopunk* will surely introduce this class of bio grease monkeys to a new segment of society, the book suffers from one serious flaw: Wohlsen, who compiled his research from 2008 to 2010, may have chronicled his subject a bit too soon. Two years on, the community has matured. Two main players in the book, for example, including Wohlsen's most magnetic character—a leather-wearing, gun-toting goth girl named Meredith Patterson—have since faded away from the movement. Meanwhile, other punks have banded together to form communities around shared equipment and projects. The group that met in my home two years ago formed a lab called Genspace in a New York City warehouse. Since then, Los Angeles and San Francisco labs have followed suit and attracted a growing number of would-be bioengineers. The difference is that many now feel less like "punks" than investors in the biotech future. **B**

Biohacking a Billion-Dollar Idea

A handy primer to biotech riches from Russell Durrett, 23, a biohacker and co-founder of New York City's Genspace lab



Step 1.

Come up with a billion-dollar idea—like a geranium that lights up green at night, yellow when it's thirsty, and red in the presence of pollution. Oh, and it smells like vanilla. This combines the functions of a night light, pollution detector, and scented candle. In other words, it's a cash machine.

Step 2.

Find a garage, clear out your old stuff, and disinfect the space. Meet your new lab.



Step 3.

Buy $5,000 worth of secondhand lab equipment on EBay. At the least, you'll need machines to copy, measure, and purify DNA, along with shakers and incubators to grow cells.

Step 4.

Order $5,000 worth of chemicals and genes. Don't worry, it's not as gross or as illegal as it sounds. Plus, genes cost only about 39¢ per base pair at mrgene.com.



Step 5.

Start a breeding program and aim for the perfect combination of traits. Use an agrobacterium—bacterium that infects plants with its own DNA—to shuttle in the new genetic code.

Step 6.

Pass your übergeranium through the U.S. Agriculture Dept. for approval to use in the environment.



Step 7.

Patent your plant, sell it to every big-box store in the U.S., and revolutionize the $12 billion horticulture industry. Set aside marketing money to combat serious fear-mongering and Tipper Gore types.

ILLUSTRATIONS BY BROWN BIRD DESIGN

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Jimmy Wales

"The idea raised tough questions. You don't want to give away too much power. What if they started endorsing a political candidate?"

The Wikipedia founder on empowering his army of volunteers while still maintaining control of the site—and not selling out



Everyone assumes it's hard for us to take no advertising on Wikipedia, but that decision was actually easy. It's just not the right place. The more difficult question for us was how we could organize and empower volunteers while still maintaining control. It's a constant balancing act to promote local autonomy with consistency across the brand.

Early on, some people thought we should radically decentralize and have local groups in different countries control their own sites. Each could have its own look and its own standards. The Germans were the first to organize and want to start a chapter. Some wanted to set up a club to represent Wikipedia there, but the idea raised tough questions. You don't want to give away too much power. What if they started endorsing a political candidate? We decided there was no way we'd do that. Still, we needed a local presence and couldn't afford to set up offices with paid staff. The best solution was to set up a local nonprofit chapter. It meant more work and sometimes more costs, but we could decide how they'd operate under our trademark.

That became our policy, but there have been challenges along the way. In China, it's almost impossible to set up a local nonprofit. We deal with the government while our volunteers can only meet up informally in bars or on social networks. For three years, Wikipedia was completely banned in the country. We're there now, though officials filter out some pages without our permission. In Italy, it was an expensive, long struggle to get through the paperwork and legal hurdles. We're setting up our own office in India soon, because we can accelerate growth there. In most parts of Africa, we don't even know where to start.

People ask why I didn't try to get rich off Wikipedia. I'm not a raging communist or anti-business—I'm just fixated with having a free encyclopedia for everyone on the planet, in their own language. Five hundred years from now, nobody will remember much that's on the Internet now. But I think they'll still point to Wikipedia. *—As told to Diane Brady*

PHOTOGRAPH BY CHRIS FLOYD FOR BLOOMBERG BUSINESSWEEK

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One Team, One Planet.
replanting
Bridgestone is organizing replanting activities that help to make a better world for all of us.
rubber tree farms
Look! Bridgestone is using natural rubber and is researching ways to enhance quality and performance.
driving campaigns
And Bridgestone's promoting eco-friendly and safety driving campaigns that help to save fuel and lives.
It's not only what you make, it's also how you make it.
cleaner factories
Constantly finding ways to make our factories even more environmentally friendly.
clean-up
We're working on social activities like clean-up programs on beaches in many locations.
retread
We're producing low rolling resistance Ecopia tires and are retreading the tires for trucks and buses. These products and practices help to reduce fuel emissions.
solar panel
And we're even making parts for solar panels that harness the sun's energy.
ecopia
Bridgestone Corporation
For your nearest Bridgestone Authorized Dealer, visit our website:
bridgestonetire.com
BRIDGESTONE
Your Journey, Our Passion

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PROFESSION: PILOT CAREER: ACTOR

People are acquainted with the star, the multi-faceted actor. But John Travolta is also a seasoned pilot with over 6,000 flight hours under his belt, and is certified on eight different aircraft. He nurtures a passion for anything that embodies the authentic spirit of aviation – like Breitling wrist instruments. Since 1884, Breitling has shared the finest hours in aeronautical history. Its chronographs, all of which are chronometer- certified by the COSC, meet the highest standards of precision, sturdiness and functionality, and with its Manufacture Caliber 01, Breitling has created the most reliable and high-performance selfwinding chronograph movement. One simply does not become an aviation supplier by chance.

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